The Economist

APRIL 4TH–10TH 2009

Economist.com

The G20 and the world economy

Indonesia, a model for Muslims

Childhood stress and poverty

Russia's show trial

A new driver at Government Motors

Under attack

A 14-PAGE SPECIAL REPORT ON THE RISE AND FALL OF THE WEALTHY

Home
This week's print edition
Daily news analysis
Opinion
All opinion
Leaders
Letters to the Editor
Blogs
Columns
KAL's cartoons
Correspondent's diary
Economist debates
World politics
All world politics
Politics this week
International
United States
The Americas
Asia
Middle East and Africa
Europe
Britain
Special reports
Business
All business
Business this week
Management
Business education
Finance and economics
All finance and economics
Economics focus
Economics A-Z
Markets and data
All markets and data
Daily chart
Weekly indicators
World markets
Currencies
Rankings
Big Mac index
Science and technology
All science and technology
Technology Quarterly
Technology Monitor
Books and arts
All books and arts
Style guide
People
People
Obituaries
Diversions
Audio and video
Audio and video library
Audio edition
The World In
The World in 2009
The World in 2008
The World in 2007
The World in 2006
The World in 2005
The World in 2004
Research tools
All research tools
Articles by subject
Backgrounders
Economics A-Z
Special reports
Style guide
Country briefings
All country briefings
China
India
Brazil
United States
Russia

Print edition April 4th 2009

Under attack
Going for the bankers is tempting for politicians—and dangerous for everybody else: leader

The world this week

Politics this week
Business this week
KAL's cartoon

Leaders

The rise and fall of the wealthy
The rich under attack

The G20 and the world economy
Be bold

Religion and human rights
The meaning of freedom

Democracy in South-East Asia
The Indonesian surprise

Russia and the rule of law
The Trial, round two

Israel's new government
Change your tune

Letters

On carbon capture and storage, Hmong women, credit-default swaps, philanthropy, the middle class, Michelle Obama

Briefing

Indonesian democracy
Beyond the crossroads

United States

The economy
A faint sound of applause

Statewatch: California
Under the tarnish, still golden

Health care
Harry and Louise ride again

The scrap-metal market
Nothing glisters

The Midwestern floods
A river runs through it, again

Florida's public defenders
Out in the cold

Lexington
A nation of jailbirds

The Americas

Mexico and the United States
Taking on the narcos, and their American guns

The Mexico-US border
Fear of violence

The progressives' Chile summit
Home truths

White-collar crime in Canada
Too trusting

Raúl Alfonsín
An Argentine democrat

Asia

India's election
Congress's great dynastic hope

Pakistan
The war on Pakistan's Taliban

Afghanistan and Pakistan
More troops and money

The Khmers Rouges and justice
The court on trial

Thailand

Previous print editions

Mar 28th 2009
Mar 21st 2009
Mar 14th 2009
Mar 7th 2009
Feb 28th 2009

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A special report on the rich

Easier for a camel
Show them the money
Bling on a budget
A thing of beauty
Dropping bricks
More or less equal?
Giving it away
Plucking the chickens
Paying the bill
Sources and acknowledgments
Offer to readers

Business

America's car industry
Time for a new driver

Carmaking in France
Mover and shaker

Computing
Clash of the clouds

Online gaming in China
Intangible value

Consumer psychology
From buy, buy to bye-bye

Face value
Ticket to ride

Briefing

The semiconductor industry
Under new management

Finance and economics

Japan
The incredible shrinking economy

Mexico and the IMF
No strings attached

Buttonwood
Minsky's moment

Regulating banks
Basel brush

The black market
Notes from the underground

Spanish banks
The mess in La Mancha

Gold
Bullish on bullion

Economics focus
The grass is always greener

Marjorie Deane internship

Correction: Globalisation and trade

Science & Technology

Neuroscience and social deprivation
I am just a poor boy though my story's seldom told

Astrophysics
Ethereal wisps

Biometrics
Knobbly ID

South Korea
Mad bullying disease

Middle East & Africa

South Africa
Politics versus the law

A mysterious air raid on Sudan
A battle between two long arms

Israel's electoral system
Make it better

Saudi Arabia's Prince Nayef
A rising but enigmatic prince

The Arab League summit
Unity of a kind

Iraq's former insurgents
Bad blood again

Europe

The Khodorkovsky case
A new Moscow show trial

Turkish politics
A wake-up call from the voters

Bosnia's future
A tearing sound

Troubled Macedonia
The name game

Charlemagne
The great euthanasia debate

Britain

Renewable energy
Greenstanding

Jacqui Smith
There's a recession on, you know

Politics and the internet
Today, Strasbourg; next, the world

British tax havens
Sinking assets

Building societies
Dunlending

Economic outlook
Glimmers of hope, forecasts of gloom

The equality industry
Rumblings in quangoland

Bagehot
Who runs Britain?

Articles flagged with this icon are printed only in the British edition of *The Economist*

International

The G20 summit
The Obama effect

Cyberwarfare
A Chinese ghost in the machine?

Religion and human rights
Diplomacy, faith and freedom

Correction: Malawi

Mining safety
Bash for help

Books & Arts

William Shakespeare
Soul of the age

Vince Cable
Spirit of the age

Eugène Ionesco's "Exit the King"
Forgotten gem

A shadow falls
In the heart of Java

Adolf Eichmann
Manhunt

The American civil war
Mule steak and dressed rat

Leaving Tangier
Tahar Ben Jelloun

Obituary

John Hope Franklin

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

Women in parliament

Trade, exchange rates, budget balances and interest rates

Markets

Sovereign bond ratings

Politics this week

Apr 2nd 2009
From The Economist print edition

Reuters

Leaders from the **G20 countries** gathered in London for an ambitious summit to discuss, among other things, the world recession and reform of the IMF. Gordon Brown, who hosted the event, earlier called for a "new deal" to tackle the financial crisis, but some countries, notably France and Germany, were reluctant to sign up to any big new stimulus packages without a significant overhaul of global financial rules. Barack Obama said America's "voracious" economy should no longer be relied upon as the sole engine of global growth. See article

At the summit Mr Obama held **bilateral meetings** with Hu Jintao, China's president, Manmohan Singh, India's prime minister, and Dmitry Medvedev, Russia's president, with whom Mr Obama discussed arms control. The American president was due to head to France and Germany for a summit marking NATO's 60th anniversary. See article

America's Justice Department asked that **Ted Stevens's** conviction for corruption be overturned. An investigation has begun into alleged misconduct by prosecutors in the case against the former Republican senator from Alaska.

Fund things to do

Mexico's president, Felipe Calderón, said his government would accept an IMF offer of a flexible credit line of up to $47 billion. Mexico is the first to say that it will use the new facility, which has no strings attached but is only available to countries with policies the fund considers sound. See article

The member countries of the **Inter-American Development Bank** (IDB) agreed to think about putting in more capital to enable it to expand its lending. The bank says its loans could total $18 billion this year, as governments seek to mitigate recession; it can only lend $8 billion a year without depleting its capital.

Manuel Rosales, the mayor of Maracaibo, **Venezuela's** second city, went into hiding. Mr Rosales was the defeated opposition candidate in the 2006 presidential election. He now faces possible arrest on corruption charges, which he asserts is a "political lynching". The government of Hugo Chávez says Mr Rosales should defend himself in court.

A bipartisan group of American senators unveiled a bill, backed by business and human-rights groups, to lift the 47-year-old ban on Americans travelling to **Cuba**.

A new surge

At a conference in The Hague, nearly 90 countries and organisations welcomed America's new strategy to deal with extremism in **Afghanistan** and Pakistan. This would combine more troops and aid with a more intense regional diplomatic effort. Iran said it would be ready to help. See article

Getty Images

Pakistan's police recaptured a police academy that had been taken over by terrorists in Lahore. The head of the Pakistan Taliban claimed responsibility and said it was in retaliation for an American drone attack. America sent another drone into Pakistan, reportedly killing 12 people. Earlier, a suicide-bomber killed scores of people at a mosque near the border with Afghanistan. See article

Researchers at the University of Toronto said they had found that almost 1,300 government-owned computers in 103 countries had been infected by **spyware**

and other secret eavesdropping devices. Their report said circumstantial evidence pointed to China as the culprit. See article

Varun Gandhi, a member of **India's** main political dynasty, was charged with attempted murder and rioting during the election campaign. Mr Gandhi had defected from the family's Congress party and was standing for the opposition Bharatiya Janata Party. See article

Repeated offence

In **Russia** Mikhail Khodorkovsky, once boss of the Yukos oil company and avowed enemy of Vladimir Putin, went on trial for a second time. He is charged with embezzling Yukos's oil. The defence claimed the trial was political: without it, Mr Khodorkovsky would have been released in two years' time. See article

A **Russian** human-rights activist, Lev Ponomaryov, was beaten up in Moscow. The attack followed the killing of a human-rights lawyer, Stanislav Markelov, earlier this year.

A prominent Chechen, Sulim Yamadayev, was reportedly shot dead in Dubai. Mr Yamadayev had fallen out with **Chechnya's** president, Ramzan Kadyrov. He would be the fourth well-known opponent of Mr Kadyrov's to be killed since September.

Hungary's ruling Socialists picked Gordon Bajnai, the economy minister, to replace Ferenc Gyurcsany as prime minister. Mr Gyurcsany resigned on March 23rd.

The ruling Justice and Development Party did badly in **Turkey's** local elections, taking 39% of the vote compared with 47% in the 2007 general election. The prime minister, Recep Tayyip Erdogan, expressed disappointment but vowed to continue with reform. See article

Bibi's back

Reuters

Binyamin Netanyahu was installed as **Israel's** prime minister at the head of a coalition government. It includes an extreme nationalist party led by Avigdor Lieberman, who becomes foreign minister, and the Labour Party led by Ehud Barak, who becomes defence minister. See article

It was reported that Israeli missiles had destroyed a convoy of lorries in north-east **Sudan** that were said to be carrying **Iranian** missiles bound for the Palestinian Hamas group in the Gaza Strip. The attack occurred in January, during Israel's three-week assault on Hamas. See article

Sunni Arabs belonging to militias known as the Sons of Iraq, who are drawn from former insurgents and now on the American payroll, clashed with units of the Shia-led Iraqi army in several districts of **Baghdad** after some of their leaders were arrested. Fears rose of a slide back into sectarian strife unless Iraqi authorities address the grievances of the Sons, some of whom have not been paid for months. See article

More than 200 African migrants trying to reach Europe were thought to have drowned off the coast of **Libya**. Hundreds of migrants have died in the past few months trying to cross the Mediterranean Sea in flimsy boats.

At a summit of the 22-country Arab League in **Qatar**, the Sudanese president, Omar al-Bashir, was warmly received, despite an international arrest warrant recently issued against him for alleged war crimes in his country's western region, Darfur. See article

Business this week

Apr 2nd 2009
From The Economist print edition

The American government rejected turnaround plans submitted by **General Motors** and **Chrysler** as inadequate. Barack Obama made it clear that he thought controlled bankruptcy might be the best answer to the two carmakers' troubles. GM was given 60 days to avoid that by prodding bondholders to accept deep discounts on the price of their debt and unions to make wider concessions. Chrysler was given a month to agree a partnership with Italy's Fiat.

Exiting Detroit

Rick Wagoner was ousted as GM's chief executive, a condition of the Obama administration's support for the company. At least six members of the board will also go. Mr Wagoner's removal at the government's behest took markets by surprise. GM's new boss is Fritz Henderson, who has held various positions at GM since joining in 1984, including chief financial officer. See article

The chief executive of **PSA Peugeot Citroën** was also defenestrated, but by his board. Christian Streiff was said to have lost the confidence of the Peugeot family, which owns nearly a third of the lossmaking French carmaker. See article

The head of **Deutsche Bahn**, Hartmut Mehdorn, resigned amid a continuing scandal about data privacy. Germany's state-owned railway company scanned the e-mail records of tens of thousands of its employees to see whether they were colluding with suppliers to steal goods. It is the latest in a series of allegations about company spying in Germany.

Barclays said it did not need to participate in the British government's Asset Protection Scheme, under which a bank's riskiest assets are ring-fenced and covered against future losses. Barclays recently passed an assessment of its ability to cope with a severe recession, such as a drop of 50% in house prices. The bank will also raise fresh capital by selling part of its iShares fund-management business, probably to CVC Capital Partners.

Britain's Treasury engineered the rescue of **Dunfermline Building Society**, a Scottish mutual lender which had chalked up £800m ($1.1 billion) in toxic loans. Nationwide, Britain's biggest building society, will acquire Dunfermline's branches and deposits with the help of £1.6 billion from the public purse. See article

Spain extended €9 billion ($12 billion) in government loans to **Caja Castilla La Mancha**. It is the first Spanish bank to be bailed out in 16 years. The governor of the Bank of Spain gave warning that more interventions may be needed. The Spanish economy is struggling more than most from a collapsing property market. See article

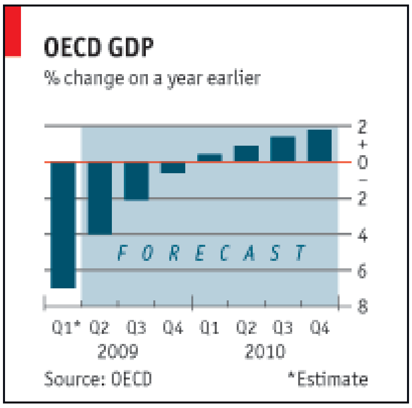
Swiss Re, the world's second-biggest reinsurer, said it would cut 10% of its global workforce within a year.

Civil fraud charges were brought against the largest fund to steer investors towards **Bernie Madoff**. Securities regulators in Massachusetts allege that Fairfield Greenwich failed to carry out due diligence when dealing with Mr Madoff, and had a "complete disregard for its fiduciary duties" towards its customers. The Massachusetts complaint does not allege that Fairfield knew Mr Madoff was running a Ponzi scheme.

Things can only get better

The **OECD** issued a grim forecast for the economies of advanced industrialised countries. The organisation expects GDP among its 30 mainly rich member states to plummet by an average of 4.3% this year.

America’s economy is projected to contract by 4%, the euro area’s by 4.1% and Japan’s by 6.6%. The **World Bank** updated its forecast for the world economy, which it now expects to shrink by 1.7% in 2009.



Another couple of twitches were detected in moribund **housing markets**. An index of pending home-sales in America, which measures sales not yet completed, rose by 2.1% in February from a month earlier. And the average price of a house in Britain unexpectedly crept up by 0.9% in March, to £150,946 ($217,000), according to a leading survey. See article

Facebook announced the departure of its chief financial officer and said it would seek a successor with experience of running a public company. This reignited speculation that the popular, free social-networking website is thinking about a public share offering.

A not-so-sunny industry

Sun-Times Media filed for bankruptcy protection, the latest newspaper publisher to go to the wall in the United States. The company prints the *Chicago Sun-Times* and dozens of other titles in the Chicago area. Like that of its rivals, Sun-Times’s advertising revenue is drying up. It is expected to fall by 30% this year.

Google began a service in China that provides links to 1.1m free, legal music downloads in the hope of boosting its share of the Chinese internet-search market.

KAL's cartoon

Apr 2nd 2009
From The Economist print edition

Illustration by KAL

The rich under attack

Apr 2nd 2009
From The Economist print edition

Going for the bankers is tempting for politicians—and dangerous for everybody else

The Bridgeman Art Library

STONES thrown through a banker's windows in Edinburgh, workers "bossnapping" executives in France, retrospective 90% tax rates proposed in Washington, and now a riot in London as G20 leaders arrived for their summit (see article). A sea change in social attitudes that could have profound effects on politics and the world economy is under way.

The rich are certainly not the only targets in the current populist backlash. Frightened by the downturn, people are furious with politicians, central bankers and immigrants. But a rising wave of anger is directed against the new "malefactors of great wealth". Today's villains are a larger and more global bunch than the handful of American robber barons Teddy Roosevelt denounced a century ago; and most of them are bankers and fund managers, rather than owners of trusts and railroads. Yet the themes are similar to those at the end of that previous gilded age: rising inequality—the top 0.1% of Americans earned 20 times the income of the bottom 90% in 1979 and 77 times in 2006—and a sense that the greedy rich have cheated decent working people of their rightful share of the pie.

Some of this cheating has been of an old familiar sort: building Ponzi schemes and bribing politicians to secure favourable deals. There are greyer areas, in which the rich hide their cash in tax havens and get tax law written to their advantage—witness the indefensible treatment of private-equity profits. But what makes the rich's behaviour so galling for many critics is that their two greatest crimes were committed in broad daylight, as they were part of the system itself.

The two great cheats

The first charge is that the rich created a new form of heads-I-win-tails-you-lose capitalism. Traders and fund managers got huge rewards for speculating with other people's money, but when they failed the parent company, the client and ultimately the taxpayer had to pay the bill. Monetary policy contributed to this asymmetry of risk: when markets faltered central banks usually rescued them by cutting interest rates.

The second charge is that the bankers and fund managers were not doing anything useful. Unlike the "deserving" rich entrepreneurs who set up Microsoft and Google, the "undeserving" traders and brokers just shuffled money around the system to nobody's profit but their own. The faster the money went round, the larger the financial sector loomed in the rich countries' economies. At its peak it contributed 41% of domestic American corporate profits, more than double the rate two decades ago. As finance

grew, the banks got ever bigger—too big to fail, eventually, so when they tottered taxpayers had to prop them up. Far from epitomising capitalism, the undeserving rich undermined it: it was socialism for the wealthy.

These two charges run together, but the second has much less justification. Enormous though the cost of bailing out the banks has been, there is nothing inherently undeserving about finance; even in their flawed state, more liquid markets have brought huge benefits to the rest of the economy. The lower cost of capital has made it easier for industry to invest, innovate and protect itself against interest and exchange-rate risk. Trying to single out financiers from entrepreneurs is a fool's errand: you will end up hurting both.

The heads-I-win charge is not entirely proven, either: some of the people who ran banks did lose when they went bust. Yet even a newspaper as inherently pro-business as this one has to admit that there was something rotten in finance: the basic capitalist bargain, under which genuine risktakers are allowed to garner huge rewards, seems a poor one if taxpayers are landed with a huge bill for it all. Hence the anger.

A time for correction and brown paper bags

Periods of excess, when inequality has grown, tend to be followed by eras of reform: Roosevelt bust the trusts and shortly afterwards Congress moved towards introducing a federal income tax. Part of the genius of capitalism is its ability to adjust to disruption from within and attacks from without.

Indeed, the system is already beginning to correct itself. As our special report this week points out, the rich are not as rich as they were: some $10 trillion, around a quarter of the wealthy's assets, has been lost. Inequality will decline. Investment banks and hedge funds are shrinking; private-equity groups are struggling to finance takeovers. Having discovered how volatile markets can be, banks will be less keen on trading in the future. There is even a correction going on in conspicuous consumption: Net-a-porter, a pricey website, offers to deliver designer outfits to its customers in brown paper bags.

The market's self-correction will not be enough, however. Higher taxes will eventually be inevitable, since so many governments have lurched heavily into deficit. But politicians must tread carefully. Tax rises right away would be a rotten idea, since for the moment fiscal stimulus is needed. And even when governments raise the money, they should first get rid of deductions and reverse unmeritocratic measures (such as George Bush's repeal of America's death tax) rather than jacking up income-tax rates to punitive levels. Squeeze the rich until the pips squeak, and the juice goes out of the economy.

As for heads-I-win capitalism, the problem of asymmetric risk should shrink, because the rule changes needed to make the financial system safer will also remove unwarranted profits. Contra-cyclical capital requirements, forcing banks to build more reserves during good times, will leave them less cash to splurge on bonuses. Many of the sweetest sources of profit sprang up in the cracks between regulatory systems; governments are now filling in these gaps. If central banks focus on asset markets when they rise as well as when they fall, they will remove much of the froth. Treat a bank that becomes too big to fail like a utility, and it will make less money.

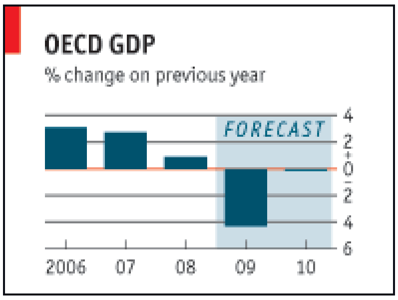
Curbing the excesses of wealth, then, will be a side effect of regulations designed to make capitalism work better. Such measures will not provide the lyrics to revolutionary anthems, but they are going to be better than going after the wealthy. The rich are an easy target. But when you try to bash them, you usually end up punching yourself in the nose.

The G20 and the world economy

Be bold

Apr 2nd 2009
From The Economist print edition

Despite unprecedented stimulus, the biggest risk is still that governments overall do too little



RARELY has a gathering of the world's most important politicians been surrounded by so much hype. The leaders of the G20 group of rich and emerging economies—who were meeting in London on April 2nd as *The Economist* went to press—came with lofty aspirations to rewrite the rules of global finance and reshape the world's financial institutions. The summit marked Barack Obama's international debut and, for added tension, was accompanied by loud and colourful anti-capitalist protests (see article). But, for all the political drama, the posturing, the preening and the outsize ambitions, history will judge the G20 leaders by a cruder criterion. Are these people, who between them run around 90% of the world economy, doing what it takes to combat the worst global recession in 80 years?

It is hard to overstate what is at stake. Since the G20 leaders had their inaugural gathering in Washington, DC, last November, the global economy has fallen off a cliff. Consumers have cut back their spending. Companies have slashed production, postponed investment and laid off workers in their millions. The financial system remains dysfunctional. Trade flows are shrinking at the fastest rates since the second world war, felling export-dependent economies from Germany to Japan (see article). Private capital flows are collapsing, devastating those emerging economies, especially in eastern Europe, that rely on foreign borrowing.

The scale and suddenness of the slump has left economic forecasters scrambling to keep up. In the latest and darkest official forecast, the OECD said this week that it expected the world economy to shrink by 2.7% in 2009. It thinks that its mainly rich member countries will see their output fall by more than 4%. That would be by far the deepest synchronised downturn since the 1930s.

Specks of gold amid the ashes

Some recent statistics, it is true, offer glimmers of hope. The latest manufacturing figures, particularly in Asia, hint at an end to the implosion of global industrial production. In America consumer spending is no longer in free fall and the housing market, where the trouble first broke out, shows some signs of stabilising (see article). In Britain mortgage lending may have hit the bottom, consumers are a little less gloomy and manufacturing looks a little less terrible. These slivers of good news have helped stockmarkets recover from their recent nadirs. But they should not be exaggerated. Plainly, the risks lie on the downside, as rising unemployment leads to a new round of spending weakness and corporate defaults create new problems in the credit markets.

Worse, the recovery, when it comes, will be feeble, as the overindebted rebuild their balance-sheets and export-dependent countries reorient their economies towards domestic spending. The OECD expects growth to stay well below its trend rate in 2010, widening the rich world's output gap—the distance between the economy's actual and potential performance—to an extraordinary 8.5% of GDP. That would push jobless rates into double digits in much of the rich world and leave many countries perilously close to deflation.

Faced with this cataclysm, policymakers have been fighting back with the biggest and most synchronised macroeconomic stimulus since the second world war. Short-term interest rates have been slashed, with several big central banks in the uncharted territory of "quantitative easing". Virtually every rich country, and many emerging ones, have put together fiscal stimulus packages. Add in the automatic impact of lower tax revenues and higher jobless payments, and the rich world's budget deficits will jump by about six percentage points of GDP. The firepower of international financial institutions, especially the IMF, is

being boosted to help those emerging economies with no room to help themselves. Governments have vowed to resist a descent into protectionism. There has been some backsliding, but no sign of a repeat of the beggar-thy-neighbour lunacy of the 1930s.

Deflation is still the greater worry

Two questions spring to the fore. Are these responses, however extraordinary, adequate? And if in doubt, should prudent policymakers err towards doing too much or too little?

At a global level, the answer is surely that boldness beats timidity. Of course there are risks in soaring government debt and swelling central-bank balance-sheets. But scaling back monetary and fiscal stimulus will be easier than digging the world economy out of a deflationary hole which, if the OECD's forecast is right, remains an uncomfortably large risk. The lesson of every big banking crisis in recent history is that rapid and decisive government action to clean up balance-sheets results in a quicker recovery and smaller long-term damage to the public purse. That is all the more pertinent this time, because the usual route out of big banking busts—recovery on the back of strong global growth—seems closed.

For individual countries, however, the calculus is often different, particularly on fiscal policy. From widening spreads on many countries' sovereign bonds to Britain's failure to sell all the gilts it wanted to at a recent auction, there are signs that stimulus has its limits for some. Gordon Brown has run out of room; Ireland is having to tighten fiscal policy. For all the efforts to bolster the IMF, some emerging-market borrowers look even worse off. Today's situation is grim, but currency crises and sovereign defaults would only make the mess worse.

What is needed, therefore, is a calibrated boldness. America's stimulus package is appropriate to its fiscal position and economic outlook. Countries with scope for more stimulus—especially Germany—should use it. Laggards in other areas must step up as well: America's plan to clean up its banks, for instance, is still inadequate. It is important too that governments do not just spend today but have credible, explicit plans for scaling back tomorrow. Perhaps most important, calibrated boldness implies not that one solution fits all, but that different countries should do different things, for the common good as well as their own. It is a state of mind—one that the G20 leaders must maintain long after this week's meeting.

Religion and human rights

The meaning of freedom

Apr 2nd 2009
From The Economist print edition

Why freedom of speech must include the right to "defame" religions

Illustration by Peter Schrank

AT FIRST glance, the resolution on "religious defamation" adopted by the UN's Human Rights Council on March 26th, mainly at the behest of Islamic countries, reads like another piece of harmless verbiage churned out by a toothless international bureaucracy. What is wrong with saying, as the resolution does, that some Muslims faced prejudice in the aftermath of September 2001? But a closer look at the resolution's language, and the context in which it was adopted (with an unholy trio of Pakistan, Belarus and Venezuela acting as sponsors), makes clear that bigger issues are at stake.

The resolution says "defamation of religions" is a "serious affront to human dignity" which can "restrict the freedom" of those who are defamed, and may also lead to the incitement of violence. But there is an insidious blurring of categories here, which becomes plain when you compare this resolution with the more rigorous language of the Universal Declaration of Human Rights, adopted in 1948 in a spirit of revulsion over the evils of fascism. This asserts the right of human beings in ways that are now entrenched in the theory and (most of the time) the practice of liberal democracy. It upholds the right of people to live in freedom from persecution and arbitrary arrest; to hold any faith or none; to change religion; and to enjoy freedom of expression, which by any fair definition includes freedom to agree or disagree with the tenets of any religion.

In other words, it protects individuals—not religions, or any other set of beliefs. And this is a vital distinction. For it is not possible systematically to protect religions or their followers from offence without infringing the right of individuals.

What exactly is it the drafters of the council resolution are trying to outlaw? To judge from what happens in the countries that lobbied for the vote—like Saudi Arabia, Egypt and Pakistan—they use the word "defamation" to mean something close to the crime of blasphemy, which is in turn defined as voicing dissent from the official reading of Islam. In many of the 56 member states of the Organisation of the Islamic Conference, which has led the drive to outlaw "defamation", both non-Muslims and Muslims who voice dissent (even in technical matters of Koranic interpretation) are often victims of just the sort of persecution the 1948 declaration sought to outlaw. That is a real human-rights problem. And in the spirit of fairness, laws against blasphemy that remain on the statute books of some Western countries should also be struck off; only real, not imaginary, incitement of violence should be outlawed.

Good manners, please; not censorship

In much of the Muslim world, the West's reaction to the attacks of September 2001, including the invasions of Afghanistan and Iraq, has been misread as an attack on Islam itself. This is more than regrettable; it is dangerous. Western governments, and decent people everywhere, should try to ensure that the things they say do not entrench religious prejudice or incite acts of violence; being free to give offence does not mean you are wise to give offence. But no state, and certainly no body that calls itself a Human Rights Council, should trample on the right to free speech enshrined in the Universal Declaration. And in the end, given that all faiths have undergone persecution at some time, few people have more to gain from the protection of free speech than sincere religious believers.

The United States, with its tradition of combining strong religious beliefs and religious freedom, is well placed to make that case. Having taken a politically risky decision (see article) to re-engage with the Human Rights Council and seek election as one of its 47 members, America should now make the defence of real religious liberty one of its highest priorities.

Democracy in South-East Asia

The Indonesian surprise

Apr 2nd 2009
From The Economist print edition

The world's biggest Muslim country has changed from authoritarian basket-case to regional role model

EPA

THE Asian financial crisis of the late 1990s helped bring regime change in both the country where it started, Thailand, and the one where the devastation it wrought was most profound, Indonesia. At the time Thailand's prospects for political stability seemed infinitely brighter. A cohesive nation whose army seemed to have withdrawn from politics, it adopted a new constitution, drafted in an impeccably consultative process. Indonesia, however, woke up in 1998 from the 32-year Suharto dictatorship with a dreadful hangover—blood on the streets of Jakarta, separatist conflicts on the periphery and a chaotic explosion of repressed political activity, some of it tinged with Islamist extremism.

Yet as Indonesia prepares for its third national parliamentary elections since then, to be held on April 9th, it has a fair claim to be South-East Asia's only fully functioning democracy. Unfettered by Thailand's draconian *lèse-majesté* laws, or the fierce interpretations of what constitutes defamation in Singapore and Malaysia, the press is vibrant and free. Unlike Thailand's army, which returned to politics with a coup in 2006, Indonesia's has stayed back in the barracks. And unlike the Philippines, where elections dominated by guns, goons and gold lead to dozens of murders, Indonesia has enjoyed a largely peaceful campaign. Indonesia's corruption rates probably still top regional charts, but the government of President Susilo Bambang Yudhoyono has made strides in attacking it.

Moreover, pluralist politics and a decentralisation of power have helped bring Islamist politics into the mainstream. Jemaah Islamiah, the local al-Qaeda franchisee, responsible for the bombing in Bali in 2002 and other attacks, has been marginalised: its most dangerous fanatics are in jail or hiding in the jungles of Mindanao in the southern Philippines. No attacks on foreign targets in Indonesia have been recorded since 2005. The above-ground Islamist parties have had to become less vehement to gain power. About two-fifths of local elections have been won by coalitions forged between Islamist and secular parties. In the two other huge Asian Muslim-majority nations—Pakistan and Bangladesh—extremism gained ground in the early years of this century in part because of the suppression of political competition.

Of course Indonesia is not a paragon of Jeffersonian democracy. The parties contesting the election (see article) are doing so largely on the basis of their leaders' charisma, and the quality of the packed lunches and other handouts they provide at their rallies. And those leaders are mostly people who thrived under Suharto, too, testifying not just to the elite's tenacious staying power, but also to the lack of any accountability for the abuses of the Suharto years. One is the former army chief, Wiranto, who was indicted by a United Nations-backed tribunal for his role in the violence that surrounded Indonesia's withdrawal from Timor-Leste in 1999. Another, Prabowo Subianto, is the divorced husband of one of

Suharto's daughters, and a former special-forces commander whose human-rights record is such that he cannot get a visa to America.

In the short term, however, the biggest difficulty facing Indonesian democracy is the election itself. Despite the experience of the previous votes in 1999 and 2004 it was always going to face huge difficulties: a voting system of Byzantine complexity; constantly evolving rules; the logistics of organising polls in an archipelago of 17,000 islands and 240m people; and the apparent ineptitude of the election commission. A new one was added, however, with the exposure of the apparent rigging of a recent election for a provincial governorship, in East Java, in favour of Mr Yudhoyono's Democratic Party.

The scale of the errors uncovered—over a quarter of the names on the voters' list were fictitious or repeated—seems too large for it to be simply an instance of incompetence. But instead of helping the investigation, the police in Jakarta intervened to downgrade it and sideline the local police chief responsible. Since then errors have been detected in voters' lists elsewhere. This makes it even more likely that many losing candidates in the election will challenge the results. Indonesia's love affair with democracy could enter a rocky patch.

Pricking the pretext of "Asian values"

It should, however, be no more than that. The manipulation was uncovered, publicised and is being exploited by opposition candidates: the system worked. As governments elsewhere in the region retreat into repression, Indonesia can still be proud of its young but vibrant pluralism. Although Malaysia's Mahathir Mohamad and Singapore's Lee Kuan Yew did most of the talking about the "Asian values" that justify authoritarianism, Suharto was their role model and proof. Indonesia is now an altogether different sort of model. Like India it has shown that democracy can work in huge, diverse and poor countries. And like Brazil, Taiwan and South Korea, it has shown it does not need generations to strike roots.

Russia and the rule of law

The Trial, round two

Apr 2nd 2009
From The Economist print edition

The second trial of Mikhail Khodorkovsky, like the first, will help determine Russia's future

Reuters

IT HAS been a big week for Russia. That is not because of the first summit meeting between the Russian president, Dmitry Medvedev, and America's Barack Obama in London. More significant was the opening on March 31st of the second trial of Mikhail Khodorkovsky, former boss of the Yukos oil company and once Russia's richest man.

To understand why Mr Khodorkovsky matters, one must go back to 2000 and the presidency of Mr Medvedev's predecessor, Vladimir Putin. Many in the West hoped vainly that Mr Putin might turn out to be a liberal. Yet the turning-point of the Putin presidency was the attack on Yukos that began in the summer of 2003. This followed a clash between the two men over corruption, and it later led to the arrest and imprisonment of Mr Khodorkovsky. These events demonstrated beyond doubt that, under Mr Putin, opposition was not acceptable, the rule of law meant the law of the ruler and the Kremlin would keep a firm grip on Russia's energy resources.

By a strange twist, the Khodorkovsky case may now become a similar turning-point for Mr Putin's protégé-turned-successor. Mr Medvedev has been in the job for almost a year. As before, some in the West hoped he might emerge as a liberal. Despite his apparent dependence on Mr Putin, now his prime minister, he insists that he is fully in charge. He has no KGB background and, within the Kremlin, has steered largely clear of the Yukos affair. Early in his presidency, moreover, he waxed lyrical about the need for Russia to strengthen the rule of law and to get away from what he called "legal nihilism".

The second Khodorkovsky trial will be the biggest test of Mr Medvedev's promises. Mr Khodorkovsky's route to riches, like that of many Russian oligarchs, was unsavoury. Yet putting him in the dock again conflicts with the "double jeopardy" principle that nobody should be tried twice for the same crime. That makes it more obvious that, as so often in Moscow's past, this is a political show trial. Even so, its outcome may be uncertain—and it may not turn out to be helpful either to the Kremlin or to Mr Medvedev himself (see article).

That is partly because the background to Mr Medvedev's presidency has changed sharply in the past year. His meeting with Mr Obama was all smiles, with new promises to press the "reset button" on bilateral relations and restart talks on nuclear disarmament—and little said about Russia's invasion of Georgia in August or America's plans for missile defences in Poland and the Czech Republic. Yet the biggest problem for Mr Medvedev lies not in foreign policy but in the economy.

Red economic blues

Under Mr Putin's presidency the bargain between the Kremlin and the Russian people was simple: you accept an autocratic regime, we will deliver rising living standards. Increasing oil prices and cheap credit produced annual GDP growth that averaged over 6% between 2000 and 2008. This year, however, lower oil prices plus the world recession could lead to a fall in Russian GDP of 6%. Unemployment is rising; inflation remains stubbornly high, at around 12%. This toxic cocktail is fast eroding Russians' confidence. And that may explain why opinion polls reveal more public sympathy for Mr Khodorkovsky in his second trial than in his first.

With little sign of a revival in oil prices, the outlook for Russia remains bleak. That makes the Khodorkovsky case and Russia's lack of a proper judicial system even more worrying. In the good times foreign investors and rich Russians alike were happy to overlook such things, just as they could ignore Russia's non-membership of the World Trade Organisation, in the pursuit of profits. But capital will be scarcer than it was for years to come. So Russia must do more to show that it is an attractive destination for investors. That means, above all, creating a safer and more predictable legal climate.

In Kafka's "The Trial", Josef K is executed without ever finding out what his crime was. At times the trials of Mikhail K have been almost Kafkaesque. For the sake of Mr Medvedev's presidency, and Russia's future, this one should be halted long before reaching any similarly grotesque conclusion.

Israel's new government

Change your tune

Apr 2nd 2009
From The Economist print edition

Or the prospect of peace with the Palestinians will grow dimmer than ever

AFP

THE outlook for peace between Jews and Arabs in the Holy Land has rarely looked bleaker, at least if you take the pronouncements of the protagonists at face value. This week the Israelis got a new government whose prime minister, Binyamin Netanyahu (left), refuses to say that the Palestinians should have a state of their own. The Islamists of Hamas, who won the last election in the Palestinian territories and may win the next, officially deny that Israel should exist at all.

Israel's assault in January on the Hamas-run Gaza Strip has failed to blot Hamas out of the equation. Mr Netanyahu has said he wants Israeli forces to "finish the job" and oust it from power in Gaza. His coalition includes an extreme chauvinist party whose leader, Avigdor Lieberman, wants to strip rights from Arab Israelis "disloyal" to the Jewish state. As Israel's new foreign minister, Mr Lieberman, who this week disavowed even the sketchy peace accord signed at Annapolis in 2007, may have to negotiate with the Palestinians and the Arab world. On the face of it, this configuration of people and power on both sides of the fence spells doom.

Yet the politics of the ill-named peace process are invariably fluid. For one thing, Mr Netanyahu is notoriously opportunistic, a quality that can sometimes be turned to a common good. He talks, albeit vaguely, of his desire to make peace with his neighbours, presumably including Palestinians. He is also said to have undertaken, as the price for drawing the less hawkish Labour party into his coalition, that he would abide by previous agreements made by Israel with the Palestinians, most of which acknowledge that the Palestinians should have their own state. Previous Israeli leaders, including Mr Netanyahu's predecessors, Ehud Olmert and Ariel Sharon, both once set their faces against Palestinian statehood but were persuaded that it was the only way to make Israel safe. It is possible that Mr Netanyahu will in due course come to see similar sense. For it will rapidly become plain that his alternative ideas—giving Palestinians "economic independence", for instance, without an actual state—are rubbish. The presence of the toxic Mr Lieberman in the foreign ministry is not itself an insuperable barrier to negotiation. The Arabs and Palestinians must hold their noses and pray that other mediators, perhaps Mr Netanyahu himself, will offer a passage towards sincere negotiation.

Fluidity on the Palestinian side is more palpable. Its two bitterly opposed wings are groping towards a unity government. In a mirror image of Mr Netanyahu's predicament, Hamas may be dragged towards accepting previous Palestinian agreements with Israel that include recognition of the Jewish state without having clearly to spit out the dreaded words of acknowledgment itself. Several Hamas leaders have also stated that if Palestinians agree in a referendum to accept Israel's existence, so be it. If a Palestinian unity government including Hamas were to be formed that disavowed violence, it would be foolish if Mr

Netanyahu refused to talk to it.

But outsiders must still help

In 2002 the Arab League, as chief advocate of Palestinian rights, promised to recognise Israel in return for a Palestinian state along the borders of 1967, with an implicit acceptance of land swaps to let some Jewish settlements on the West Bank stay in Israel. That promise, reiterated by the Arab League this week, still stands. But greater American involvement and flexibility, both lacking for too long under George Bush, are crucial.

Until now, Barack Obama has been oddly shy of embroilment, partly because of the lack of a solid Israeli government. That excuse no longer holds. He and his secretary of state, Hillary Clinton, have declared that securing two states, of Israel and Palestine, must be the sole basis of a deal. America cannot give unstinting support to an Israeli government that says it is resiling from the fundamental principle of two states and will continue to colonise the West Bank. If Mr Netanyahu does not change course, Mr Obama should reduce aid to Israel. He must also strive, through the offices of his envoy, George Mitchell, or through other mediators, to bring Hamas into negotiations. That way, grim as the outlook is, it need not be hopeless.

Economist.com OPINION LETTERS

On carbon capture and storage, Hmong women, credit-default swaps, philanthropy, the middle class, Michelle Obama

Apr 2nd 2009
From The Economist print edition

The benefits of CCS

SIR – Your leader on carbon capture and storage (CCS) claimed that "the world is investing too much cash and hope" in the technology in the expectation of delivery from global warming ("The illusion of clean coal", March 7th). Science informs us that climate change is a serious issue and requires serious funding in all low-carbon technologies: renewables, energy efficiency, nuclear and CCS. The United Nations Intergovernmental Panel on Climate Change maintains that CCS could contribute 55% of all emission reductions by 2100 and reduce the cost of stabilising carbon dioxide by more than 30%. The International Energy Agency says that stabilising emissions without CCS is not only impossible but raises costs by over 70%, an additional annual cost of $1.28 trillion by 2050.

The technology is ready and public investments in CCS represent excellent value for money. Europe will need to spend €13 billion-18 billion ($17 billion-24 billion) a year to meet its renewables targets. The lifetime costs of the European Union's CCS demonstration plants are €5 billion-13 billion. Yet one large-scale CCS power plant can supply the equivalent low-carbon electricity of 1,400 wind turbines.

The truth is the world is investing far too little in CCS and other low-carbon technologies. Investments in these areas are not an act of faith, but an environmental imperative.

Milton Catelin
Chief executive
World Coal Institute
London

SIR – In looking for cost-efficient CCS, please step up and walk to your window, where you may see a tree. The evolution of woody plants has solved the problem of capture (photosynthesis) and storage (formation of durable cells) at minimal cost. After what is called "forest transition", woody resources of a country cease to shrink and start to expand. Forest transition implies a shift of the landscape from a carbon source to a carbon sink, thus marking the onset of organic, cheap CCS.

Alexander Mather of the University of Aberdeen predicted in 1992 that forest transition is the likely future of tropical countries, too. Since then, however, biofuel clearings and other pressures have created new concerns. Organic CCS will again become an issue as climate negotiators reconvene to consider a post-Kyoto treaty in Copenhagen in December this year.

Pekka Kauppi
Professor of environmental science and policy
University of Helsinki
Helsinki

SIR – I am quoted in your briefing, but I appear to be saying that CCS can only be afforded with public subsidy ("Trouble in store", March 7th). That is not my view and it is not the case. Subsidies will be needed for "early mover" demonstration plants, but CCS is expected to become fully competitive with other low-carbon technologies as the industry matures, assuming realistic carbon prices. Indeed, it will be comparable with most renewables, even wind power, in the cost of carbon dioxide avoided.

The rationale for CCS is to tackle climate change, not to preserve coal; CCS is needed for gas too. The point is decarbonisation of power generation. Until the day when the world can supply its colossal energy needs with 100% renewable energy, we need to decarbonise existing fossil-fuel power production, and CCS is a vital part of the carbon abatement strategy.

Philippe Paelinck

Director of CO_2
Alstom
Paris

The following letters on CCS appear online only

SIR – Your coverage of CCS is overly pessimistic. You argue that CCS is unproven because no power plants use it today, yet you do not recognise the economic reasons behind this. Speeding up the deployment of CCS requires a carbon market, emission standards and some early financial incentives. Effective carbon policies can break the existing economic barriers and deployment should bring significant cost reductions. As for the ability of geological formations to retain carbon dioxide, the IPCC has concluded that retention will likely be 99% or more over 1,000 years.

We have all done substantial research on nearly all aspects of CCS. It is no silver bullet, and coal will not be "clean" even if its carbon emissions are scrubbed. But scientists, many environmentalists, companies and policymakers are united in recognising the potential safety and efficacy of this technology at well selected and regulated sites, the barriers to which are chiefly economic. Climate change demands quick action and our enormous fossil-fuel base makes CCS a valuable addition to the climate protection toolbox.

Sally Benson
Executive director
Global Climate and Energy Project
Stanford University

Mark Brownstein
Managing director of business partnerships
Environmental Defence Fund

James Dooley
Senior staff scientist
Joint Global Change Research Institute

Julio Friedmann
Leader
Energy and Environment Directorate
Carbon Management Programme
Lawrence Livermore National Laboratory

David Hawkins
Director of climate programmes
Natural Resources Defence Council

Howard Herzog
Principal researcher
CCS Technologies Programme
Laboratory for Energy and the Environment
Massachusetts Institute of Technology

Susan Hovorka
Principal investigator
Bureau of Economic Geology
University of Texas

SIR – The risks of building a CCS plant on a commercial scale are too large for any government to reasonably expect the private sector to bear alone. Yet the benefits to us all would be huge. Carrying all the risks and getting only a small part of the rewards is unlikely to appeal to shareholders.

In this sense CCS is no different from the historical development of nuclear, wind, solar and other technologies. Government, scientists and business must continue to join together to develop and commercialise new technology and ensure that the benefits are available to all.

Neil Bentley

Director of business environment
Confederation of British Industry
London

SIR – Your briefing observes that firms currently refuse to make big investments in CCS technologies. This is not a surprise. Given the high irreversibility of CCS investments, the high degree of uncertainty (technical, commercial, political, regulatory) and the operational flexibility to defer the investment, firms tend to be reluctant in making any investments in energy solutions.

Under current market conditions and uncertainties an investment in CCS technology for a power plant seems to be unprofitable and will therefore be postponed indefinitely. The vast amount of uncertainty puts more value on waiting rather than committing to an investment. With the Kyoto protocol expiring in 2012 and being renegotiated in December this year, the sooner policymakers offer a clear strategic choice to firms, the sooner CCS investments will occur.

Peter-Jan Engelen
Associate professor of corporate finance
Utrecht University
Utrecht, the Netherlands

SIR – You conclude that CCS "is mostly hot air." Using data from the UN advisory panel on global warming, we found the yearly carbon-dioxide output of coal-fired power plants in the United States contributes 0.27% to the atmospheric reservoir of carbon dioxide. The flow of this contribution is 1.34% of the total carbon dioxide circulating between earth and its atmosphere. To suggest that we can measure carbon dioxide reservoirs or carbon dioxide flows with the accuracy required of these percentages, an accuracy required if we are to infer our efforts at carbon dioxide abatement are a success, is another sort of pollution: smoke and mirrors.

William O'Neill
Professor of statistics
Bioengineering department
University of Illinois at Chicago
Chicago

SIR – In Canada, we have a provincial premier who allows unchecked expansion of one of the world's dirtiest sources of energy, Alberta's tar sands, while the federal government touts its investment in CCS as an environmental "plan". Nonsense. Emissions should have a price and polluters should develop new technologies if they intend to stay in business. What a great place to let the free market run wild with innovation.

Mauricio Curbelo
Toronto

How to help Hmong women

SIR – Your story on the kidnapping of Hmong women across Vietnam's border with China was well told, but your conclusion was disappointingly limited ("Bartered brides", March 14th). Police work, as important as it may be, is not enough by itself to provide the solution to stop this "cruel trade".

Behind the exotic scenery and their colourful costumes, the ethnic minorities living along the Chinese border face abject poverty. In this context, working with women's groups to improve their lives seems a better way to achieve results. Educating Hmong women, empowering them, and thus allowing them to protect themselves by standing up to a stranger and saying "no" is a very different approach, and one that is showing results. I witnessed this myself while visiting villages around Lao Cai where ActionAid, an international anti-poverty organisation, in partnership with local communities, is implementing this type of work.

Alexandra Mitsotaki
Chair
ActionAid Hellas
Athens

Faulting credit-default swaps

SIR – The usefulness of the credit-default-swaps (CDS) market in raising funds and credit-risk management is today much less obvious than its dangers (Buttonwood, March 14th). So many people take it for granted that the CDS market "indicates" a genuine market-perception of credit risk. In fact, this market is opaque, often illiquid, and prone to manipulation. Sellers of CDS need high ratings or cash to use as collateral, which are rare these days. Prices can therefore rise in a void, putting downward pressure on shares and bonds of any company. Rating agencies often take their lead from CDS price levels, which tells us how dubious they have become, at least for regulatory purposes.

This creates ideal conditions for short sellers, and if there is some Dr Strangelove-type entity out there, such as a "short only" hedge fund or a rogue state, that wants to destroy any remaining confidence in the financial system, it can easily do so by manipulating CDS prices on corporate and sovereign risk. This could continue until either the whole system collapses, or the CDS market is brought into an organised exchange with a central counterparty, or forbidden altogether, at least until its cost/benefit ratio is substantially improved.

Eric De Keuleneer
Professor
Solvay Brussels School of Economics
Brussels

Xavier Becerra

SIR – Your article on charitable foundations completely misrepresented what I have said and done on matters of philanthropy ("Taking from the givers", March 21st). I have never "threatened to remove tax exemptions from foundations." I have called for more transparency within and oversight over the charitable world. These are two very different—obviously different—things.

Xavier Becerra
House of Representatives
Washington, DC

The following letter appears online only

The global middle class

SIR – Several years ago we predicted the emergence of a global middle class composed mostly of people from developing countries, so we read your special report on the new middle classes in emerging markets with great interest (February 14th). We would like to share an update and make a point of clarification. First, our original estimates, published in the 2007 Global Economic Prospects report and cited by you, have been revised in parallel with the purchasing-power parity adjustments of the new World Bank international poverty line of $1.25 per person per day. We now estimate that 270m residents of developing countries belonged to the global middle class in 2005, a sharp reduction from an earlier figure of 400m (extrapolated from the 2000 estimate of 250m).

There are also important compositional changes: the proportion of East Asian residents in the global middle class has gone down by half, while that of east European residents has roughly doubled. Second, we believe Surjit Bhalla's estimates of the global middle class, which you used also, drastically overinflates the actual number. Mr Bhalla estimates that 57% of the world earns between $10 and $100 per day, whereas the new World Bank poverty estimates show that 47% of the global population lives on less than $2 per day. Combining these poverty estimates with Mr Bhalla's figures leaves no people earning between $2 and $10 per day, or above $100. In contrast, according to World Bank estimates only 16% of the world earns an income within what Mr Bhalla considers to be the global middle class thresholds.

Maurizio Bussolo
Senior economist
World Bank

Rafael De Hoyos
Chief of advisers
Mexico Under-Secretary of Education

Denis Medvedev
Economist
World Bank

Shall not be infringed

SIR – Lexington accurately noted how Michelle Obama could employ her intelligence, energy and family history as a spokesperson for American values and to inspire us to work together as a society (March 21st). Lexington also mentioned that the White House has engaged in a debate with the media about whether Mrs Obama should show her “perfectly toned” upper limbs in public.

Being familiar with constitutional law, perhaps Barack Obama could put this particular fashion controversy surrounding his wife to rest by referring to the second amendment’s right to bare arms.

Skip Kilmartin
El Sobrante, California

Indonesian democracy

Beyond the crossroads

Apr 2nd 2009 | JAKARTA
From The Economist print edition

The election may be a shambles, but democracy is thriving

EPA

UNDER Suharto, the dictator who ruled for 32 years until 1998, Indonesian parliamentary elections were not so much rigged as scripted. But the pointless campaigns were lively, colourful affairs, giving an impressive imitation of the forms of democracy. Now that Indonesia enjoys the substance, too, political parties can give full vent to the voters' enthusiasm. The campaign for the parliamentary election on April 9th, the third since Suharto's downfall, has been a carnival of democratic competition: flag-waving, horn-honking processions; television-advertising blitzes; mass rallies with a few speeches, gifts of free T-shirts, 20,000 rupiah ($2) notes and, most important, singing and dancing.

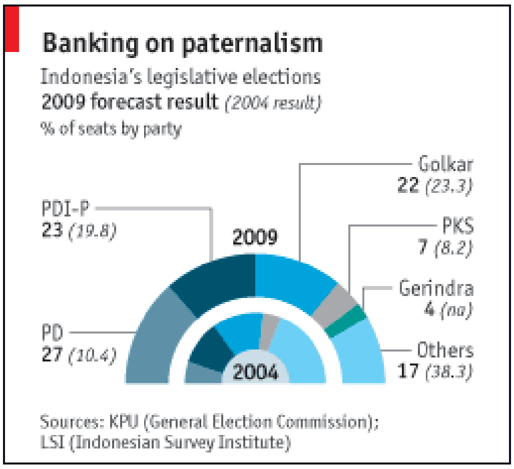
The poll itself is an exercise whose scale and logistical complexity are second only to those of a general election in India. Across more than 900 inhabited islands, 171m people have registered to vote. They have 38 national parties to choose from, and an estimated 800,000 candidates for the national parliament, known as the DPR, and lower-level provincial and other legislatures. And this is only the start of what may be a three-stage process. Parties, or coalitions of parties, that win at least 112 seats in the 560-member DPR, or 25% of the popular vote, may nominate candidates for the powerful presidency, to be elected in July. If no candidate wins more than 50% of the vote then, there will be a run-off in September.

Indonesia's national motto is "Unity in Diversity", and there is a surprising degree of consensus about the likely outcome of all this: the re-election of Susilo Bambang Yudhoyono, who in 2004 became Indonesia's first directly elected president, for a second five-year term. But even if the consensus is accurate, there is great uncertainty about the shape of the coalition he will lead, which depends in part on the results of the parliamentary vote.

Opinion polls (see chart) suggest many voters have yet to make up their minds but that the new DPR will probably be dominated by three parties: the president's Democratic Party (PD), which basks in the glow of his own popularity and is expected to double its share of votes to more than 20%; Golkar, which was once a vehicle for Suharto's re-election but which serves in the PD's coalition and is led by Josuf Kalla, the vice-president; and the main opposition, the Indonesian Democratic Party of Struggle, or PDI-P, which is the heir to the nationalist movement of independent Indonesia's founder, Sukarno, and is led by his daughter, Megawati Sukarnoputri, whom Mr Yudhoyono replaced as president.

The next administration will be another coalition. If Mr Yudhoyono and Mr Kalla remain on the same ticket, they will be hard to beat.

But Mr Kalla has said he will contest the presidency himself, forging an alliance with the PDI-P and others. If he does, which is not certain, that might leave Mr Yudhoyono's secular PD leading a coalition of smaller parties, of which the most important are Islamist ones.



Thinking back to the political chaos, bloodshed and economic meltdown that surrounded Suharto's departure, it is hard not to be impressed that the legitimacy of this convoluted process seems to enjoy such general support in Indonesia. Democracy has taken root and flourished. Though it is still finding its way—and there are many reasons to worry about the forthcoming election—democracy's achievements are worth enumerating.

In a country with a history of political violence, the campaign has been largely peaceful and good-humoured, as it was in 2004. An exception has been Aceh, where a separatist insurgency ended with an agreement on local autonomy in 2005. The first local legislative elections in Aceh are being held alongside the DPR vote. Three former insurgents have been mysteriously murdered. The army accuses the former separatists' party, Partai Aceh, of continuing to espouse independence.

Separatists in restive regions such as Papua and Maluku can still be locked up for unfurling flags, as they were after a demonstration in Papua in March; four Dutch journalists were briefly detained for covering that episode. The army is accused of abuses in Papua of the sort it once perpetrated in both Timor-Leste and Aceh. But elsewhere, claims Amien Rais, a leader of *reformasi*, the turbulent reform movement that toppled Suharto, Indonesia has a free press and "100% political liberty".

The Indonesian miracle

The army is back in the barracks. Under Suharto it had *dwifungsi*, the "dual function" of running the country as well as defending it. It also oversaw a huge business empire, since partially dismantled, and was guaranteed enough seats in the parliament to ensure its privileges could not be chipped away. Now not only are serving soldiers barred from political office; the 410,000 members of the armed forces do not even have the vote. Six would-be candidates for the presidency are retired generals, including Mr Yudhoyono. But most Indonesians seem to expect the army to remain neutral during the elections.

Moreover, in the country with more Muslims than any other (nearly 90% of a population of about 240m), political Islam is firmly in the moderate mainstream. Indonesia has done well in rounding up Jemaah Islamiah, the al-Qaeda affiliate responsible for the 2002 Bali bombing. Some forms of Islamic orthodoxy—women wearing headscarves, for example—are more prevalent than a decade ago. And in the last DPR election, about 40% of the vote went to parties broadly defined as Islamist.

They have since played a role in promoting two regrettable pieces of legislation: one, to curb "pornography", which though much watered down, might be used to ban such joys as traditional dancing; and one stopping Muslims belonging to the Ahmadiyah sect from proselytising. There has also been a worrying tolerance for thuggery by Islamist vigilantes. But, despite claims by some "nationalists" (as secularists like to call themselves) that extremists are taking over Indonesia by stealth, the country does not seem to be creeping towards fundamentalism.

In the early months of *reformasi*, dozens of Islamist parties sprang up. Most have since vanished or become part of the mainstream. To win power nationally and in local elections they have had to adopt a more secular image, or form coalitions with secular parties. Opinion polls have found dwindling support for the regulations based on *sharia* that some local governments have introduced.

The Prosperous Justice Party, or PKS, for example, grew out of the underground campus resistance to Suharto. H. Zulkieflimansyah, a PKS leader in the DPR, explains that religious activism was less tightly constrained than the political sort. Its precursor organisation grew into a nationwide network. In the 2004 elections it put this to good use, winning more than 7% of the vote. But he says the party, which joined the governing coalition, is between the rock of not alienating its core Islamist support and the hard place of needing to attract secular voters. The PKS, like most Islamist parties, is expected to fare worse in this election than it did in 2004.

Another largely successful reform is the radical decentralisation that has seen a big chunk of public-sector spending and power devolved to local levels. Parties that have done badly locally will now pay a price at the national level. The *reformasi* has also introduced a new sense of accountability, which has done a bit to rein in the still rampant corruption. So has the capture of some big fish. They include the father of Mr Yudhoyono's daughter-in-law, one of several corruption suspects at the central bank, and so many DPR members that a judge asked if every law discussed there needs to be lubricated with cash.

Same old, same old

The persistence of pervasive corruption after the departure of the Suharto kleptocracy is only one of the clouds over Indonesia's vibrant new democracy. Another is the continued dominance of Suharto-era figures. All the main contenders for power are survivors of that period. Even Ms Megawati, as part of the licensed opposition under Suharto, is a relic of his "New Order" regime. Blink, and *reformasi* looks less like the revolution it seemed to herald and more like a tactical manoeuvre to help the old Jakarta elite to cling to power. Blaming the stultifying environment of the Suharto years, optimists hope a new generation of leaders will emerge by the next elections in 2014. Indonesians, says Eva Sundari of the PDI-P, are not yet ready to elect a juvenile such as Barack Obama.

The absence of political debate in the campaign is also dispiriting. So thin is the ideological divide, for example, that the two main rival presidential candidates could be the incumbent and his deputy. Asked what Golkar stands for, Burhanuddin Napitupulu, a leading party strategist, seems flummoxed. "Prosperity and nationalism," he eventually comes up with. Similarly, the goals of the PKS, as defined by Mr Zulkieflimansyah, are "the reform of the Islamic community", and the aim of reform is "prosperity and justice", roughly the PKS's name. He pins some hopes on the party's high position on the ballot paper. Likewise, the Golkar bigwig thinks his party has an edge because of its campaign colour, an "eye-catching" yellow.

A PD vice-chairman, Darwin Saleh, cheerfully concedes the party's hopes rest on the president's popularity: "paternalism will be dominant for the next ten years." The PDI-P, as an opposition party, has a clearer platform: against privatisation and for stronger workers' rights. But it is still less closely identified with a manifesto than an individual—Ms Megawati, whose undistinguished presidency and aloof style are handicaps.

Two other parties are simply bandwagons for the presidential ambitions of Suharto-era generals. Wiranto, a former army chief implicated in the violence that accompanied the breakaway of Timor-Leste in 1999, heads Hanura. Prabowo Subianto, the former head of a notorious special-forces unit, who went into exile after being involved in the kidnapping of political activists in 1998, heads Gerindra. Of the two, Gerindra has created the bigger splash. Financed by Mr Prabowo's billionaire brother, it has poured money into TV advertising, and offers members an innovative freebie: one-year's worth of premiums for life-insurance policies that would pay out about $200, a fortune to most. Its populist message may have won it 13m members but this need not translate into votes.

The absence of real policy debate provokes an understandable response: growing apathy. The percentage of voters who opt, in the Indonesian term, for *golput*, or the "white party"—ie, do not vote or else spoil their ballots—was widely watched in the Suharto days as a measure of tacit dissent. In 2004 the *golput* rate, just 5% in 1999, reached 25%, and is expected to climb further this year.

The number of Indonesians unrepresented in the new DPR will rise because of the threshold that parties have to cross before any of their candidates are allowed seats: 2.5% of the national vote. There is no second-preference system, so those votes, which may account for as much as 20-30% of the total, are in effect ignored. Defenders of the system point out the importance of thinning the numbers of parties. But that is to ignore the likely alienation of voters in provinces, such as Papua, still chafing at rule from Jakarta.

In yet another reform, voters will pick individual candidates not party lists. So it is possible that some might win the popular vote but not be elected because their parties nationally fall short of the threshold. That is one of many reasons to expect the results to produce consternation, wrangling and legal challenges.

Dictatorship was so much easier

Many Indonesians are not even sure how to cast their votes, after a planned shift from hole-punching to box-ticking was aborted (both are now allowed). Folding the bath-towel-sized ballot paper will also be tough, and voting will take so long queues will need patience. By April 1st the software to transmit the results had still not been installed, 5.7m ballot papers had been found to be invalid and many others had not reached the polling stations. Unlike India, Indonesia does not stagger its election, though some Christian districts will be allowed to delay voting a few days.

Most seriously, questions have been raised about the voters' lists, after a scandal this year over a governor's election in East Java, in which more than a quarter of the names on the list were found to be duplicates or bogus. The enterprising police commander who made this discovery was chivvied into retirement three months early and the investigation downgraded, giving the impression of a cover-up.

Whether or not there was an attempt to rig the election in East Java—or something similar is planned nationally—the mess highlights the weakness and ineptitude of the independent election commission. This is in part a result of a corruption scandal in 2004, which saw some commissioners go to jail. Not only did that deter potential recruits, it also meant that the commission's budget is now on a much tighter leash.

With so many problems, there have been calls for a delay in the vote. They are unlikely to be heeded. Even the PDI-P's Ms Sundari would be opposed. Candidates, she says, cannot afford an even longer campaign. And the move from a party-list system has created tremendous friction within the parties. They want the election over with.

The electoral stimulus

All that money the candidates have been splashing out is useful at a time when Indonesia's economy is cooling sharply in the draught from the global downturn. Exports, dented by falling demand and collapsing prices for commodities such as coal and palm oil, were down 36% in January in value terms compared with a year earlier, according to Mari Pangestu, the trade minister. The central bank expects a decline of 25-28% for 2009 as a whole. Most economists expect GDP growth to slow to about 3% from 6.1% in 2008.

That is still a far cry from the cataclysm of 1998, when the rupiah collapsed and the economy shrank by 13.1%. The rupiah has weakened moderately in recent months, and the government has been arranging back-up swap arrangements with multilateral banks and other countries, including a $15 billion facility from China.

EPA

Yudhoyono sings the blues

The government has announced its own fiscal stimulus of 73.3 trillion rupiah, about $6 billion, or 1.4% of GDP. Most of it will be in the form of tax cuts, with only 17% devoted to infrastructure and poverty relief. That is in part a reflection of the government's lack of capacity. Though the need of better infrastructure is desperate, the government knows that promising to throw money at the problem is an inefficient way of generating economic activity.

There could have been no more graphic or terrible illustration of this than a disaster which struck on

March 27th. The Situ Gintung dyke burst in the middle of a night of heavy rain. Within minutes it had tipped 2m cubic metres of water from a reservoir onto the township of Cirendeu, just outside Jakarta. More than 300 houses, a school and a college campus were deluged. Rescuers and residents picked through the mud, finding nearly 100 bodies. Residents say that cracks in the dyke, built by the Dutch in 1933, had been spotted a year ago, but nothing had been done. The disaster was worsened by the illegal building of houses under the dyke.

Many other existing dams need urgent repairs; many new ones are planned but unbuilt. This is, in part, an unwanted by-product of decentralisation: inept local authorities sit on funds for projects they cannot get started. The corruption implied by the illegal building did not extend to oiling the wheels to get the dyke fixed. Those who stayed despite knowing the dangers—some even practised evacuation drills—must have been trapped by poverty.

People do not seem to blame Mr Yudhoyono for all this or, reasonably enough, for the global slump. Judging from the polls and anecdotal evidence, he is seen as a decent man struggling to deal with a series of calamitous acts of God—the 2004 tsunami hit just after he took office. The anti-corruption drive has been popular, as have cash handouts for the poor, introduced last year to compensate for rising fuel prices. Some 19m poor families are receiving 100,000 rupiah a month.

If Mr Yudhoyono is criticised, it is as a ditherer and fudger—not the worst faults in somebody negotiating the survival of a new democracy. A bigger danger to his record, and to that democracy itself, would be a badly flawed election. It is not just for the president’s sake that it matters that Indonesia’s great electoral drama, against the odds, goes all right on the night.

The economy

A faint sound of applause

Apr 2nd 2009 | WASHINGTON, DC
From The Economist print edition

Some signs suggest that the recession is lifting, but the path to recovery is fraught with danger

Getty Images

THE current recession has broken many of the rules of business cycles, but not this one: when something gets cheap enough, buyers emerge.

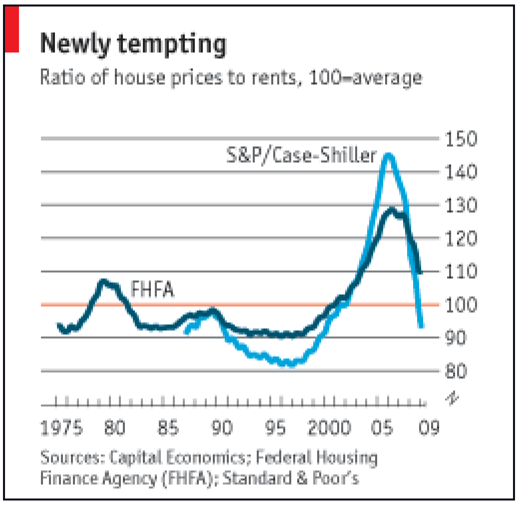
America's housing bubble seems mostly deflated. According to the S&P/Case-Shiller 20-city index, house prices through January were down 29% from their all-time peak. Relative to incomes, houses are now 10% undervalued, and relative to rents they are fairly valued, thinks Paul Dales of Capital Economics, a consultancy.

This is luring buyers back. House sales rose unexpectedly in February. The National Association of Realtors estimates that up to 45% of existing homes sold were "distressed" properties—those in, or close to, foreclosure. In Nevada, which with California, Florida and Arizona was the epicentre of the boom and bust, fourth-quarter sales were more than double their level a year earlier. Keith Kelley, a Las Vegas estate agent, has an investor interested in offering about $80,000 for a foreclosed, four-unit apartment building which, fully let, could bring in over $25,000 a year in gross rent. He has two buyers interested in paying $220,000 for a five-bedroom house that sold in 2004 for more than triple that. Their monthly mortgage payment would be about half the rent on a similar property. Even so, he says, "I still talk to buyers waiting to see when we get to the bottom." Indeed, homes may be fairly valued now but could get dirt cheap if, as commonly happens, prices overshoot.

The stabilising of the housing market is one of several tantalising glimmers that the end of the recession may be in sight. In March factory purchasing managers were their least gloomy about new orders since last August. Vehicle sales rose 8% in March from February. New claims for unemployment insurance have stopped rising. Gross domestic product, which shrank at a 6.3% annual rate in the fourth quarter, probably shrank at a similar rate in the first, but the composition of the drop was more encouraging; it was driven not by the collapse in consumer spending, but by sinking output as businesses sought to bring inventories into line with lower sales. Second-quarter growth "has a good chance of being positive", according to Ian Morris and Ryan Wang, economists at HSBC, though "the risks…are still huge."

What has brought this turnabout? In part, the normal corrective powers of the economy. Larry Summers, Barack Obama's main economic adviser, has noted that current annualised vehicle sales of about 9m are well below the 14m necessary for replacement

and rising population, while annualised housing starts are about a quarter of the rate needed to support the forming of new households.

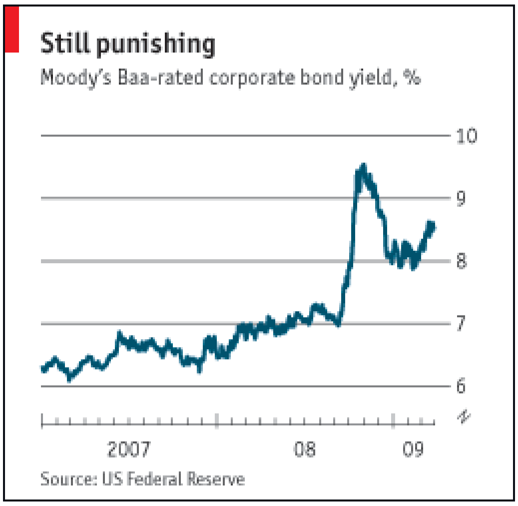


The improvement is also the expected response to monetary and fiscal stimulus, both of which have been exceptionally aggressive. The Federal Reserve, having lowered short-term interest rates in effect to zero, has intervened in bond markets to push down long-term mortgage rates as well. On April 1st paycheques were due to begin reflecting the tax cuts in Barack Obama's $787 billion fiscal stimulus.

As investors have shifted their economic outlook from catastrophic to merely grim, the stockmarket has shot higher, by 19% on April 1st from its 12-year low on March 9th. Like houses, stocks look cheap. Strategists at Deutsche Bank estimate that investors can expect to earn an additional seven percentage points over the long run from holding stocks instead of Treasury bonds, the highest such "equity risk premium" in at least 25 years. Mr Summers says it may be "the sale of the century".

Yet even if the bottom in economic activity is in sight, a robust recovery almost certainly is not. Housing usually leads the way out of recession as falling interest rates unleash pent-up demand. But easy credit in earlier years has turned many renters into homeowners already. At the end of last year 67.5% of households owned their home, down from a peak of 69% in 2006 but still well above the 64% that prevailed from 1965 to 1997. Moreover, many prospective buyers cannot take advantage of low mortgage rates because higher down-payments are now required.

The tonic of lower interest rates has been dulled by the dysfunctional financial system. That is why credit markets have not reflected the optimism of stocks and are forcing corporations to pay punitive yields on the bonds they issue (see chart).



Consumer spending may also be depressed for some years to come by the record 18% collapse in household net worth over the course of last year, a drop of $11 trillion. That is a chief reason why the OECD on March 31st released an exceptionally gloomy prognosis, predicting that the American economy would shrink by 4% this year and not grow at all next year. Deflation, it said, "may become a threat".

The greatest risk of renewed recession or stagnation comes from the banking system. As long as home prices keep falling and unemployment keeps rising, banks' bad loans will keep mounting. Huge questions hang over the Treasury's plan to remove those loans, and many economists think it must commit more public capital than the already authorised $700 billion in TARP money. Perversely, a continued stockmarket rally could undermine the chances of more aid, lulling some in Washington to believe enough has been done.

Tim Geithner, the treasury secretary, understands that. "The big mistake governments make in recessions", he said on March 29th, "is…they see that first glimmer of light, and the impetus to policy fades." Yet he hurt his own case the same day by saying that more TARP money is not needed for now because some banks will repay the government capital they have previously received. That is bad news, not good news: banks are lining up to repay the money to free themselves from political interference, even though the loss of capital will constrain their lending. That increases the odds of a multi-year, Japanese-style credit crunch.

Even if the administration wants the money, Congress at present is in no mood to grant it. The Senate and House budget resolutions were silent on the administration's request for $750 billion in extra funds (with a budgeted cost of $250 billion). The administration is wisely waiting for tempers to cool before asking for the money.

Statewatch: California

Under the tarnish, still golden

Apr 2nd 2009 | LOS ANGELES
From The Economist print edition

Its economy is dismal, its politicians worse. But nowhere can reinvent itself so capably as California

PITY California. Not only must it endure an epidemic of foreclosure, a 10.5% unemployment rate and the lowest bond rating of any state. It is also suffering a critical assault. In the past few weeks *Forbes*, *Fortune*, *Newsweek* and the *Wall Street Journal* have all published scathing reviews of California. Even this newspaper has called it ungovernable. Although many other states have been knocked by the recession, none has been kicked so enthusiastically while down.

The most trenchant critic is Joel Kotkin, an urbanist at Chapman University. Mr Kotkin, who defended California during the early 1990s recession, now believes it is decaying. In his view, the state has been captured by environmentalists and slow-growth zealots who are stymieing house-building and running down dirty industries like agriculture and manufacturing. They are turning California from a place of working- and middle-class opportunity into a playground for the rich and a trap for the poor.

Criticism from academics and journalists is one thing. But residents seem to agree. The latest poll by the Public Policy Institute of California reveals a state ill at ease with itself. Fully 77% of likely voters believe it is on the wrong track. Arnold Schwarzenegger, the governor, may be admired outside the state, but only 33% of Californian voters think he is doing a good job. He fares better than state legislators, whose positive rating is just 11%.

California has great problems, many of which are likely to intensify over the next year or so. But not all the charges levelled at the state are fair, and most of the critics have overlooked some crucial strengths. Even in a downturn it retains mighty economic advantages. It quietly plays a vital role in shaping American society. When the recession releases its grip, its strengths will again become apparent. Underneath the tarnish, the state is still golden.

One charge is wholly accurate. California's politics have been dysfunctional for a long time and are getting worse. A particularly precise gerrymander in 2000 left virtually every political district safe for either Democrats or Republicans. As a result, most races are decided by the ideological purists who turn up to vote in party primaries. This means a Democratic caucus in thrall to the teachers' unions and environmental activists and a Republican posse that believes there is hardly an economic or social problem that cannot be solved by slashing taxes. Mr Schwarzenegger came to Sacramento hoping that the two camps would bond over cigars in his smoking tent. They are farther apart than ever.

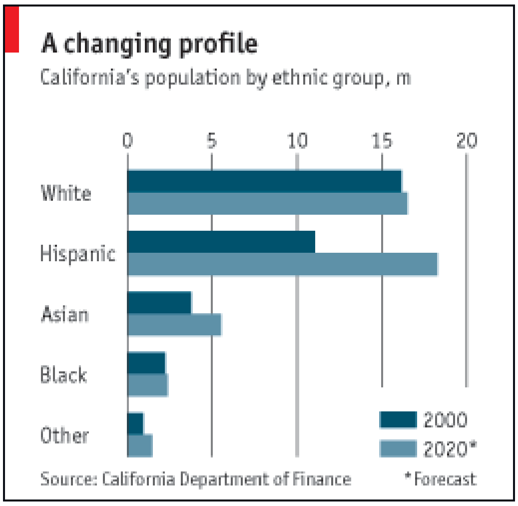
Such political dysfunction is especially painful when one considers California's past triumphs. By the late 1960s the state had built a vast system for moving water, turning the semi-arid Central Valley into the world's most productive farmland. It had created a chain of superb universities. In Los Angeles it pioneered a motorway-oriented, low-rise, multi-centred urban model which has become the template for many other cities in the West and beyond.

It is a tough, perhaps an impossible, act to follow. If California fails to live up to its glorious past, so does every other state. Yet it is worth remembering that the golden age was not equally delightful for everyone. Many cities enforced rigid racial segregation. People buying homes in southern California are still occasionally surprised to encounter deeds banning sales to blacks and Hispanics, which must be waived. Segregation helped create vicious ghettos ruled, barely, by paramilitary-style cops.

All that has changed dramatically. Los Angeles, which the rapper Ice-T dubbed "home of the body bag" in 1991, is now one of the best-policed cities in America. Last year it recorded only a shade more violent crime per person, and much less property crime, than smug Portland in Oregon. Even with more than one in ten people out of a job, the drop in crime continues.

Hispanics and Asians are expected to account for nearly all of California's population growth by 2020 (see chart). But not all the newcomers will stay within its borders. One way of looking at the state is as a kind of human-processing machine. It sucks in immigrants from Asia and Latin America, turns them into Americans and then disgorges some of them, along with many natives, across the country.

It is not an easy task. The mass migration of unskilled labourers from Mexico and El Salvador helps to explain California's notoriously poor schools, although it certainly does not excuse them. Break down pupils by race, and the state's schools get results as good as (or, more accurately, as bad as) those in Utah.



The relentless flow of immigrants and ethnic groups into and around California has led to some ugly, racially tinged clashes. But there is a great deal of muddling along too. Listen, for example, to the extraordinary collision of Spanish and English, of Hispanic, black and Anglo musical traditions, on Latino FM, 96.3 on the Los Angeles radio dial. Californian Asians have created a new culture by mixing Chinese, Japanese, Taiwanese, Korean, Vietnamese and American cultures.

The place for talent

California's businessmen chafe under too many regulations, some of them created with the laudable aim of protecting the environment. Small operators are being pinched by rises in sales and income taxes designed to balance the budget. Sensing discontent, cities like Denver are trying to lure businesses away from California. This is a worry but also, as Jack Kyser of the Los Angeles County Economic Development Corporation points out, a compliment. Of course others are coming to California in search of talent: that is where much of it is.

Nobody has yet succeeded in breaking California's dominant position in two industries. The first is technology. Silicon Valley attracted 39% of all venture capital in America last year. It remains the heart of an industry that has become more dispersed, stretching from Boston and Texas to India and Israel. And nowhere can match the Valley for restless innovation. David Crane, who advises Mr Schwarzenegger on the economy, calls it "ground zero for creative destruction".

The second, rather less glamorous, industry is international trade. The ports of Los Angeles and Long Beach are America's biggest. In 2007 they handled more than half the containers entering America, Canada or Mexico from the west. When trade is brisk, the ports support a vast transport and logistics industry and even some light manufacturing (Los Angeles County alone has more manufacturing jobs than Michigan). This twin economic engine is sputtering now, thanks to the collapse in consumer spending and, with it, world trade. But expect it to start humming again as soon as the economy recovers.

California is not suffering economically because it has failed to provide jobs and build houses for people of modest education and average means. It is in trouble precisely because it has been so successful in doing so. As trade through the ports boomed in the middle of this decade, so did house-building. Between 2000 and 2008 the Inland Empire, a sprawling two-county area east of Los Angeles, added an astonishing 840,000 residents. Many were Hispanics buying property for the first time. Far from dying, the California dream thrived in the desert.

The trouble was that the new residents could not really afford their houses. As prices began to fall and mortgage rates were reset, places like the Inland Empire began to suffer. A whirlwind of foreclosures demolished property values, pitched more than 150,000 builders out of work across the state, wrecked bank balance-sheets and eventually contributed to a worldwide recession. The trouble has now spread far beyond subprime mortgages.

The damage has not been limited to California. Arizona and Nevada have seen similar rates of foreclosure as well as deeper job losses and bigger budget deficits. Jobs have also vanished from former economic hotspots such as North Carolina and Florida. California thus finds itself in excellent company.

Although it has been extremely painful, the collapse of California's property market has solved a major problem. It was largely thanks to overpriced housing that the state lost almost half a million residents to

other states between 2004 and 2008. But property prices in southern California have fallen by 39% from their peak, according to the S&P/Case-Shiller 20-city index, while prices in the Bay Area are down by 43%. As a result, estate agents report some signs of recovery in demand if not in prices. And those who buy will be inclined to stay.

The state will soon get a chance to resolve some of its other problems. Last November, by the narrowest of margins, voters agreed to allow a committee to redraw the political boundaries. When that happens, in 2012, politics should become slightly less partisan. An even bigger opportunity for reform will come next year, when voters will be asked to approve the creation of open primaries. That measure is on the ballot only as the result of a late-night deal in February. With no budget agreed and with the state facing fiscal oblivion, a lone state senator was able in effect to request a rewriting of the state constitution.

All rather messy, but this is how California works. The state is restless, chaotic and experimental. Few places make as many mistakes as California; fewer still have the capacity to recover from them so quickly. As John Husing, an Inland Empire economist, puts it: “California is made up of people who don’t know what it is they are not supposed to do.”

Health care

Harry and Louise ride again

Apr 2nd 2009 | NEW YORK
From The Economist print edition

Will insurers once again scupper health-care reform?

THE final nail in the coffin of Hillarycare came when Harry and Louise appeared on television. Hillary Clinton's effort to introduce a government-run health system over a decade ago fell apart when two worried, middle-aged Americans were shown equating reform with bloated bureaucracy. That ad was paid for by the health-insurance lobby.

Now Barack Obama says that reform is a priority again. He argues that the recession only adds urgency, as there is no way to tackle long-term deficits without fixing health care. Kathleen Sebelius, his new nominee for the post of secretary of health and human services, this week pointed out to a Senate committee that nearly half of all recent home foreclosures have resulted, in part, from families being hit by health expenses not covered by insurance.

So it would be rum indeed if the latest reform efforts were also shipwrecked by the insurance lobby. At first the industry made noises of general support, and its lobbyists joined various bipartisan efforts to broker a deal. But relations are turning frosty again. Senator Jay Rockefeller, head of the Senate's Commerce Committee, dragged a leading insurance boss into a hearing on March 31st to face allegations of overcharging.

That show trial came on the heels of a warning from leading insurance lobbies that they will oppose any reform effort that calls for a government-run insurer to compete against private firms. Nancy Pelosi, the House speaker, and other liberals strongly favour such a proposal. Mrs Sebelius was forced this week, when grilled by Senator John McCain, to confirm that she supports having "a public option side-by-side with private insurers".

So is the "greedy" insurance lobby getting ready again to skewer reform? The industry's foes certainly think so. Such folk want a muscular government-run insurer to compete against the rapacious private insurers, and so get costs under control while expanding coverage. Boosters of "public provision" think that if Medicare, the government health scheme for the elderly, were opened to all comers, it could squeeze savings out of hospitals just as Wal-Mart does from its suppliers.

That seems plausible; but look closer, and it turns out the insurers are not being unreasonable. For one thing, although Wal-Mart is a giant it does not also regulate itself and impose price controls (as a federal insurance scheme could). A recent study by the Commonwealth Fund, a think-tank, calculates that a strong government insurer could suck away 65m-70m customers from private rivals.

Experience with Medicare offers one reason to treat Ms Pelosi's proposal with caution. Denis Cortese, head of the Mayo Clinic, a respected hospital chain, worries that any new government insurer would underpay hospitals for care, forcing a shift of costs on to private insurers. These, in turn, would be forced to pass on that cross-subsidy as higher rates for corporate clients. Various studies have shown that this is what is happening today. Dr Cortese estimates that Medicare underpaid his outfit by $840m last year alone.

Regina Herzlinger of Harvard Business School points to another reasonable worry. Medicare's apparent cost advantage over private insurance comes in part because of accounting trickery. Unlike the private sector, the government scheme is allowed to use a cash accounting method that does not require it to set aside funds to meet all future obligations. She notes that "the government does not have the $36 trillion needed to finance the services it has promised to those who pay for Medicare."

Members of both the House and Senate are busy crafting health-care bills. They should be ready in June. Senator Ronald Wyden, a Democrat, says he is confident that reform will happen this year. Even when pressed about the ruckus raised by the insurers, he insists this is not a repeat of Hillarycare: "This time,

we've got a foundation of bipartisan support."

Fine, but what happens if the House version insists on a federal insurance scheme? In practical terms, this need not be the death of the industry. Paul Mango of McKinsey, a consultancy, thinks private firms can still compete against a stodgy, if cheaper, government rival by offering more innovative products and services.

In political terms, however, this issue could kill health reform. That is not just because the insurance industry has already dug in its heels. Though they are staying quiet for now, it is clear that many employers and health-care providers, fearing higher costs, are also opposed to a federal insurance plan. Republican leaders, including Senator Charles Grassley, appear eager to capitalise on this issue. So if Mr Obama wants to avoid battling the formidable Harry and Louise, he would be wise to steer clear of this proposal.

The scrap-metal market

Nothing glisters

Apr 2nd 2009 | BALTIMORE
From The Economist print edition

Falling metal prices cripple the scrap industry

CALL it an instance of the butterfly effect. The thieves who sawed through the bleachers at Kenwood High School, in east Baltimore, and sold them for scrap did not know they were working for contractors in São Paulo and Shanghai, but they were. A spike in metal prices from 2003 through the first half of 2008—fuelled by a building boom in emerging markets, especially in the BRIC countries—have led metal thefts in Baltimore County to increase by as much as 1,195% since 2005. As those economies have cooled, however, demand and metal prices have both plunged. Good news for spectators of high-school sports, but awful for the scrap industry.

The scrap-metal trade exists across the country. Any activity that uses metal generates scrap, and scrap can be recycled for a variety of uses: it goes into 60% of all metals and alloys produced in America. Baltimore is blessed with excellent water and rail access (great for sending scrap onward, or overseas) and a strong manufacturing tradition, both factors that have led to an old and diverse scrap industry in the city.

Yet Baltimore has not been spared America's manufacturing decline. Sparrows Point, a promontory just outside Baltimore's city limits jutting into Chesapeake Bay, once housed the world's largest steel mill, which stretched for four miles and produced steel for ships, guns, ammunition and bridges, including the George Washington in New York and San Francisco's Golden Gate. In 1957 59,000 people worked there; in 2005 just 1,500 remained, and the mill has changed hands four times since 2001 (its current owner is Severstal, a big Russian steel company).

Today, half-empty warehouses dot the seven-and-a-half-acre yard of Terrapin Recycling, an industrial scrapyard just north of Sparrows Point. To an outsider all appears busy enough. A baler noisily crushes steel into easily shippable cubes; workers are dwarfed by towering bins of car-parts, copper wire and turnings that glisten softly like huge metal snowdrifts.

But Terrapin's volume is down by 60% since the middle of 2008, a pattern repeated throughout the industry. Bruce Savage of the Institute of Scrap Recycling Industries says the industry "fell off a cliff", starting in September and October. In the middle of 2008 copper was selling for $4 a pound; by year's end that price had fallen to $1.40. Aluminium fell from $1.50 a pound in the middle of the year to 66 cents. Both foreign and domestic demand have declined. In 2007 the United States exported $21.7 billion-worth of scrap; if current trends continue that figure could fall by half, or worse.

Adding insult to injury, a Baltimore County executive says that metal thefts have merely stopped increasing; they have yet to decline. The thief who hacksaws off your catalytic converter may get less money than he bargained for at the scrapyard, but that's cold comfort when you're walking home.

The Midwestern floods

A river runs through it, again

Apr 2nd 2009 | CHICAGO
From The Economist print edition

Fargo's frantic efforts are the latest chapter in a long struggle

AP

Too late for sandbags or watchdogs

THE Red river has a record of unruly behaviour. In 1826 it expelled white settlers from a colony along the modern American-Canadian border. A photograph from 1897 shows two women in prim hats paddling glumly through the streets of Fargo, in the young state of North Dakota, after another epic flood. The 20th century brought its own disasters, capped by the 1997 flood. This was the worst in 100 years, sparing Fargo but inflicting more than $1.5 billion-worth of damage on Grand Forks, 80 miles (129km) to the north. Then came this year's flood.

"I thought the 1997 flood was the benchmark for the future," says Fargo's mayor, Dennis Walaker. "It is just unbelievable to see what's happening to us this year." After a snowy winter the river rose quickly. On March 13th John Hoeven, North Dakota's governor, issued a disaster declaration; 11 days later President Barack Obama followed suit. Local forces worked feverishly, joined by the National Guard, the Border Patrol, the Army Corps of Engineers and others. On March 28th the river rose to a perilous 40.8 feet (12.4 metres) in Fargo, surpassing the 1897 record. The city's dykes mostly stood firm. Now, for the moment, the water is receding.

But it will surely rise again. Flooding is part of any river's nature, explains Donald Schwert, a geologist at North Dakota State University, and the Red river is particularly fond of spilling over its banks. Because it runs north, between North Dakota and Minnesota to Lake Winnipeg in Canada, chunks of ice sometimes form a dam. Melting snow swells the river as the spring thaw moves north. Floods spread wide, without any hills to contain them.

Grand Forks can now observe the floods with relative calm: after the 1997 devastation, the government (local and federal) spent $409m to build flood walls, a diversion channel and a greenway to accommodate insistent water. But Fargo's fight against the river has involved fewer concrete walls and more rushing about: since destruction was averted in 1997, it has never built a permanent anti-flood system. Some of this year's measures, such as the use of 3.5m sandbags, have been old fashioned, others more common in Iraq than North Dakota. Unmanned Predator drones have monitored the river's progress from the sky. Black Hawk helicopters have gingerly placed one-tonne sandbags in the water to shore up vulnerable dykes.

Mr Walaker wants Fargo to build a more permanent solution to flooding. But winning support for such projects is not easy. Residents have short memories. Some object to walls that would cut off access to the river. Modest plans to protect the city's south side are only creaking forward. The Army Corps of Engineers is studying a variety of measures, but its report is not expected until 2010. Meanwhile the Red river will continue to do what it does best. It is expected to crest again in mid-April.

Florida's public defenders

Out in the cold

Apr 2nd 2009 | TAMPA
From The Economist print edition

How cuts may be illegal

THE Miami-Dade County Public Defender's Office has had enough. Overworked and underfunded in its efforts to provide lawyers for the poor, it tried last June to decline all new non-capital cases. In September a judge ruled that it could turn away so-called third-degree felony cases, such as people pulled in for possession of soft drugs. On March 30th three appellate judges heard arguments as to whether the September ruling was valid.

Public defenders in Florida's 20 judicial circuits have a crushing workload: in some cases, more than double the 200 cases a year that their association recommends. And ever since the state legislature cut their funds in the latest budget squeeze, they have been struggling with less money and lower pay. But to withdraw from cases, or to refuse to take them, may be illegal under both Article I, section 9 of the Florida constitution (due process) and the federal constitution, which guarantees both due process under the 14th amendment and the right to counsel.

Florida was the origin of *Gideon v Wainwright*, a case that prompted the Supreme Court to rule, in 1963, that anyone accused of a felony had the right to a lawyer. The decision also noted that if the defendant was too poor to hire a lawyer, the state should provide one for him. That charitable thought seems to have withered in the cold blasts of the recession. In Florida's 5th judicial circuit, a five-county area about the size of Connecticut with more than 1m people, the public defender's office has lost $209,000 in recent cuts. “In the last 18 months, we've lost 12% [of our budget],” says Michael Lupton, the office's director. Florida's other 19 public defender's offices have faced sharp cuts, too.

Lack of money hampers public defender's jobs in all sorts of ways. They cannot have clients evaluated by psychiatrists. It is harder, if not impossible, to appeal rulings that go against clients. And any hope of a pay rise for their long days is now a distant dream.

As for the cases that are turned away, the judge's ruling in September would send them to the Office of Regional Council, a small consortium of lawyers who do pro bono work. Cases rejected by the council would be passed on to private lawyers. And how would those be paid? More than likely, the taxpayer will end up footing the bill.

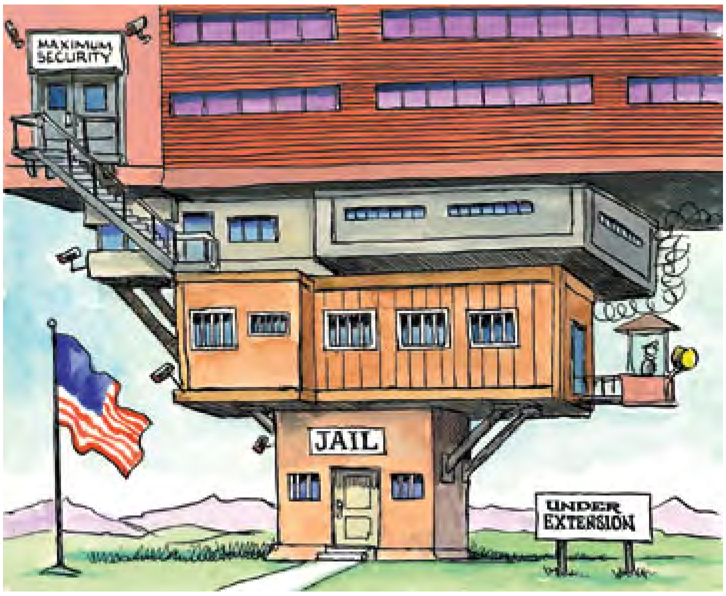
Lexington

A nation of jailbirds

Apr 2nd 2009
From The Economist print edition

Far too many Americans are behind bars

Illustration by KAL



THE world's tallest building is now in Dubai rather than New York. Its largest shopping mall is in Beijing, and its biggest Ferris wheel in Singapore. Once-mighty General Motors is suspended in a limbo between bail-out and bankruptcy; and the "war on terror" has demonstrated the limits of American military might.

But in one area America is going from strength to strength—the incarceration of its population. America has less than 5% of the world's people but almost 25% of its prisoners. It imprisons 756 people per 100,000 residents, a rate nearly five times the world average. About one in every 31 adults is either in prison or on parole. Black men have a one-in-three chance of being imprisoned at some point in their lives. "A Leviathan unmatched in human history", is how Glenn Loury, professor of social studies at Brown University, characterises America's prison system.

Conditions in the Leviathan's belly can be brutal. More than 20% of inmates report that they have been sexually assaulted by guards or fellow inmates. Federal prisons are operating at more than 130% of capacity. A sixth of prisoners suffer from mental illness of one sort or another. There are four times as many mentally ill people in prison as in mental hospitals.

As well as being brutal, prisons are ineffective. They may keep offenders off the streets, but they fail to discourage them from offending. Two-thirds of ex-prisoners are re-arrested within three years of being released. The punishment extends to prisoners' families, too. America's 1.7m "prison orphans" are six times more likely than their peers to end up in prison themselves. The punishment also sometimes continues after prisoners are released. America is one of only a handful of countries that bar prisoners from voting, and in some states that ban is lifelong: 2% of American adults and 14% of black men are disfranchised because of criminal convictions.

It is possible to pick holes in these figures. Some of the world's most repressive regimes do not own up to their addiction to imprisonment (does anyone really believe that Cuba imprisons only five in every 1,000 of its citizens?). No sane person would rather be locked up in Russia or China than in America. A country as large and diverse as America boasts plenty of model prisons and exemplary training programmes. But all that said, the conclusion remains stark: America's incarceration habit is a disgrace, wasting resources at home and damaging the country abroad.

Few mainstream politicians have had the courage to denounce any of this. People who embrace prison reform usually end up in the political graveyard. There is no organised lobby for prison reform. The press ignores the subject. And those who have first-hand experience of the system's failures—prisoners and ex-prisoners—may have no right to vote.

Which makes Jim Webb all the more remarkable. Mr Webb is far from being a lion of the Senate, roaring from the comfort of a safe seat. He is a first-term senator for Virginia who barely squeaked into Congress. The state he represents also has a long history of being tough on crime: Virginia abolished parole in 1994 and is second only to Texas in the number of people it executes.

But Mr Webb is now America's leading advocate of prison reform. He has co-sponsored a bill to create a blue-ribbon commission to report on America's prisons. And he has spoken out in every possible venue, from the Senate to local political meetings. Mr Webb is not content with incremental reform. He is willing to tackle what he calls "the elephant in the bedroom"—America's willingness to imprison people for drug offences.

Does Mr Webb have any chance of diminishing America's addiction to incarceration? History is hardly on his side. For most of the 20th century America imprisoned roughly the same proportion of its population as many other countries—a hundred people for every 100,000 citizens. But while other countries stayed where they were, the American incarceration rate then took off—to 313 per 100,000 in 1985 and 648 in 1997.

Mr Webb also has some powerful forces ranged against him. The prison-industrial complex (which includes private prisons as well as public ones) employs thousands of people and armies of lobbyists. Twenty-six states plus the federal government have passed "three strikes and you're out" laws which put repeat offenders in prison for life without parole. And the war on drugs has pushed the incarceration business into overdrive. The number of people serving time for drugs has increased from 41,000 in 1980 to 500,000 today, or 55% of the population of federal prisons and 21% of those in state prisons. An astonishing three-quarters of prisoners locked up on drug-related charges are black.

Up for a fight

But Mr Webb is no ordinary politician. He packed several distinguished careers into his life before becoming a senator—as a marine in Vietnam, a lawyer, a much-published author and secretary of the navy in the Reagan administration. And he is not a man to back down from a fight: one of his best books, "Born Fighting: How the Scots-Irish Shaped America", celebrates the martial virtues of the clan to which he is proud to belong.

Some signs suggest that the tide is turning in Mr Webb's direction. Congress passed the Prison Rape Elimination Act in 2003. Barack Obama's Justice Department has hinted that it wants to do something about the disparity in sentencing between blacks and whites for drug crimes. Support for both the death penalty and the war on drugs is softening: a dozen states have legalised the use of marijuana for medical purposes. If Mr Webb can transform these glimmers of discontent with America's prison-industrial complex into a fully fledged reform movement, then he will go down in history as a great senator.

Lexington now writes a blog, which is open for comment at Economist.com/blogs/lexington

Mexico and the United States

Taking on the narcos, and their American guns

Apr 2nd 2009 | EL PASO AND MEXICO CITY
From The Economist print edition

Senior American officials are trooping to Mexico with assurances of support in its drug war. Will warm words be backed up by action?

Reuters

ARIZONA'S attorney-general, Terry Goddard, says he started to worry about American guns ending up in the hands of Mexican drug traffickers two years ago. That was after a meeting in Cuernavaca with Mexico's attorney-general, Eduardo Medina Mora, who urged him and several of his counterparts from other American states to enforce the law banning the export of assault weapons that can be legally bought north of the border. Keen to help, Mr Goddard spent months building a case alleging that George Iknadosian, the owner of a Phoenix gun shop, had knowingly sold some 700 assault weapons to "straw men" working for the narcos. It could have been a landmark case. Mr Iknadosian pleaded not guilty, and last month a state judge threw out all the charges against him on a point of law. Prosecutors blamed a clash between federal and state law on arms smuggling.

This is just one example of how hard it will be for the United States to implement its promise to collaborate with Mexico in quelling drug-related violence. But Mexican officials are pleased that at least the promise has been made. During a two-day visit last month, Hillary Clinton, the secretary of state, admitted that America's "insatiable demand for illegal drugs fuels the drug trade" and that "our inability to prevent weapons from being illegally smuggled across the border to arm these criminals causes the deaths of police officers, soldiers and civilians" in Mexico.

Her visit was the clearest sign that the American administration has woken up to what is at stake in the battle unleashed by Mexico's president, Felipe Calderón, against the drug "cartels", in which 10,000 people have died since December 2006. She was to be followed on April 2nd by Janet Napolitano, the secretary for homeland security, and Eric Holder, the attorney-general. Barack Obama himself will drop in for talks with Mr Calderón before both attend the Summit of the Americas in Trinidad on April 17th.

"They finally started paying attention," says Arturo Sarukhan, Mexico's ambassador in Washington. That is partly because some Americans fear the violence is starting to spread northward, although such

worries look exaggerated (see article). But it is also in part owing to a war of words that has raged across the border in recent weeks.

This began with a report in November from the United States Joint Forces Command bracketing Mexico and Pakistan as the two countries most at risk of becoming “failed states”. Dennis Blair, the new director of national intelligence, then told a Senate committee that the corruption and violence of the drug cartels was hindering the Mexican government from controlling part of its territory. Having largely ignored Mexico’s fight against the drug gangs for the past two years, American television has suddenly latched on to it, in sensationalist terms. Spurred on by his own media, Mr Calderón, by instinct an American ally, responded by accusing American officials of corrupt complicity in the drug trade.

So Mrs Clinton’s comments were welcomed in Mexico. As to whether the words will lead to practical co-operation, Mexican officials say they are getting more help with intelligence on the drug gangs from their American counterparts. But Mrs Clinton’s promise of Black Hawk helicopters for the Mexican police was undercut by Congress’s pruning of funding for the Mérida Initiative, a plan under which Mexico was to receive $1.4 billion in aid over three years. American officials now say they will seek to reverse the cut. But more than aid, Mexico wants the Americans to crack down on drug consumption, as well as the movement of guns and money southward. That is where the big difficulties lie.

The Obama administration promises to send several hundred more agents to the border, both from the Bureau of Alcohol, Tobacco and Firearms and from Immigration and Customs Enforcement. The idea is that they will search southbound traffic and railcars. Mr Calderón wants the Americans to tip off their Mexican counterparts about gun trafficking, and to curb gun sales. Mrs Clinton said she favours the reinstatement of a federal ban on selling semi-automatic “assault weapons” such as AK-47s. Mexican police claim that since the ban lapsed in 2004, the cartels have become much more powerfully armed: of 30,000 guns they have seized since December 2006, 15,000 are assault weapons, nearly all bought at the 7,500 or so gun shops on the American side of the border.

But the gun lobby opposes the ban. John Barrasso, a Republican senator from Wyoming, said in El Paso this week that violence in Mexico is an argument for more assault weapons, not fewer: “Why would you disarm someone when they potentially could get caught in the crossfire?” He continued: “The United States will not surrender our second-amendment rights for Mexico’s border problem.”

Facing so many other battles, Mr Obama would surely prefer not to be drawn into this one. Mr Sarukhan says that merely enforcing existing gun laws would be a big help. For Mexico, too, there are dangers in framing its relations with the United States purely around security. Trade, economic integration and immigration are equally vital. For now, however, the drug war has captured the headlines in both countries, leaving the politicians with no choice but to respond.

The Mexico-US border

Fear of violence

Apr 2nd 2009 | EL PASO
From The Economist print edition

But still pretty safe—on the northern side

IS MEXICO'S drug war moving north? In Maricopa County, which encompasses Phoenix, officials are alarmed by a spike in kidnappings for ransom and "other Latin American-style violence". Rick Perry, the governor of Texas, wants the federal government to deploy 1,000 National Guard troops and six helicopters in his state. A spokeswoman for the governor said that the request, which the administration is considering, is to prevent the situation worsening.

But many mayors along the border say that troops are not needed, at least not yet. They dismiss such talk as alarmist. "The sky is falling? Well, here comes more funding," says Chad Foster, the mayor of Eagle Pass. He says that his town, on a rugged stretch of the Texas border, is fine. He crosses the border to Piedras Negras daily, even though his sister in Los Angeles called and warned him not to go to Mexico.

On March 30th the United States' Senate Committee on Foreign Relations held a hearing on border violence at the campus of the University of Texas in El Paso. Jaime Esparza, the El Paso district attorney, said that he had not seen an increase in violence and nor had his colleagues in other Texan border cities.

El Paso's Mexican sister city, Ciudad Juárez, is a different matter. With 2,000 killings since January 2008 it has become notorious (though the violence has abated since Mexico's government sent 8,000 troops last month). El Paso itself had only 19 murders during the same period. Local leaders point out that their city is one of the safest in the United States, with a far lower crime rate than Washington, DC, the nation's capital.

Downtown Ciudad Juárez has a forlorn air. The red-light district, a few blocks from one of the international bridges, was knocked down a few years ago and the area has not been redeveloped. Along the main pedestrianised street many shops are shuttered, windows are broken and pavements are crumbling. Heavily armed troops are stationed throughout the town.

El Pasoans say they feel safe at home, but nowadays make fewer trips across the border. Trini Lopez, the mayor of the suburb of Socorro, says that people have disappeared from his town and later been found dead in Mexico. For the time being, he is advising people to stay safe by staying in Socorro.

The progressives' Chile summit

Home truths

Apr 2nd 2009 | VIÑA DEL MAR
From The Economist print edition

A global alliance of the centre-left is (scratchily) back in business

AP

Bachelet's lesson for Brown

THEY govern in very different continents, but there is a degree of ideological kinship between some of the centre-left governments in South America, Europe and now the United States. All are trying to mix the economic efficiency prized by the right with the social justice championed by the left. Back in the days of Tony Blair and Bill Clinton this link was formalised in "progressive governance" get-togethers. These have been revived: the latest meeting took place in Viña del Mar, a Chilean seaside resort, on March 27th and 28th. Yet this time, thanks to the world recession, the differences between participants from north and south seemed wider.

The leaders of Chile, Brazil, Uruguay and (less convincingly) Argentina reckon their countries have followed progressive policies more rigorously than their friends in the north. They expressed anger that the crisis has halted five years of rapid economic growth in Latin America. In an oddly racist comment, Brazil's president, Luiz Inácio Lula da Silva, said it was all the fault of "white, blonde, blue-eyed" bankers. He added, even more bluntly, that three of his fellow-summiteers, Britain's Gordon Brown, America's vice-president, Joe Biden, and Spain's José Luis Rodríguez Zapatero "unfortunately carry most responsibility for the debacle."

Chile's president, Michelle Bachelet, reminded the visitors that because her country had saved much of its windfall copper revenues during the boom, her government can now safely stimulate the economy for several years. That drew praise from Mr Brown, who pointed to Chile as proof that "progressive politics can change the world." But Ms Bachelet's homily was promptly construed by Mr Brown's Conservative opponents back home as a put-down of his past fiscal laxity. The fact that the meeting was being held in the southern hemisphere for the first time was also seen by some as a symptom of the world's changing balance of power.

Amid the barbs were some common beliefs, such as the need for not just for fiscal stimulus but a better balance between state and market. All agreed with Mr Brown's idea for an export-credit fund to get trade flowing again. All solemnly denounced protectionism (even if some are starting to practise it). For Latin America, the meeting carried another meaning: when it comes to engaging with the rest of the world, there is a gulf between the "progressive" left and the self-styled "21st-century socialists", led by Venezuela's Hugo Chávez. Mr Chávez got the message. He complained that Ms Bachelet had "endangered South American unity" by inviting along, in Messrs Brown and Biden, "two representatives of the empire".

White-collar crime in Canada

Too trusting

Apr 2nd 2009 | OTTAWA
From The Economist print edition

Why does justice move so much more slowly north of the 49th parallel?

OUTSIDERS tend to think of Canada as a wholesome, boy-scoutish kind of place. Many Canadians have the same view. Yet their country is as shockingly slow as many in Latin America when it comes to dealing with allegations of corruption and white-collar crime, as a rash of recent cases demonstrates.

Public hearings began this week in a judicial inquiry into the relationship between Brian Mulroney, a former prime minister, and Karlheinz Schreiber, who was once a lobbyist for Airbus and for Thyssen, a German defence and steel company. The matter under investigation dates back to 1993, when Mr Mulroney is alleged to have accepted the first of three envelopes stuffed with cash from Mr Schreiber. It is six years since these payments became public knowledge.

Yet the inquiry is the first attempt by the government to get to the bottom of the affair. Mr Mulroney says that the cash—C$225,000 ($170,000 at the time) he says; C$300,000 says Mr Schreiber—was payment for lobbying work carried out after he ceased being prime minister, and he insists he has done nothing wrong. But should the inquiry's findings lead to criminal charges against him, the subsequent trial would probably drag on for several more years.

This is what happened in the case of Garth Drabinsky and Myron Gottlieb, two Canadian theatre impresarios from a company called Livent who were convicted of fraud on March 25th. They were indicted in the United States in 1999, and promptly fled to Canada where they were not charged until 2002. Justice has moved only slightly faster in the case of Larry O'Brien, the mayor of Ottawa, who was charged 16 months ago with trying to bribe an opponent in an election in 2006. His trial begins next month.

Canadian sloth in these matters is shown up by American zeal. Conrad Black was jailed for fraud south of the border but was never charged in his native Canada, although some of the press baron's offences were committed there. The contrast stems in part from differences between legal systems. America's grand juries, which have no counterpart in Canada, allow investigators to subpoena witnesses and require them to testify under oath. Plea bargaining provides another tool to extract evidence. Canadian police must rely on voluntary co-operation from busy businessmen. If they procrastinate, cases may be dropped because witnesses die or because of undue delay, as happened with Robert Topol, a third Livent manager. Another time-consuming Canadian procedure requires police to disclose all documentary evidence when they file charges.

A bigger factor may be public attitudes. Canadians tend to defer to authority and trust their institutions. Although the main parties, the Liberals and the Conservatives, play up corruption claims to gain political advantage, their outrage rarely provokes a public groundswell in favour of speedy action or change. The exception was a scandal over Liberal advertising spending, which cost the party the 2006 election.

The Liberals have had little success in trying to tar Stephen Harper, the Conservative prime minister, with the problems of Mr Mulroney, who formerly acted as a mentor to him. Mr O'Brien has refused to step down as Ottawa's mayor. The Canadian Broadcasting Corporation plans to air a new series of a talent show in which Mr Drabinsky is one of the judges. Mr Mulroney continues to sit on several corporate boards. "Canadians are complacent about these things," says Tony Coulson of Environics, a polling firm. At this rate they won't earn their boy-scout's badge for housecleaning.

Raúl Alfonsín

An Argentine democrat

Apr 2nd 2009 | BUENOS AIRES
From The Economist print edition

A flawed politician of rare integrity

HE WAS perhaps the only Argentine political leader of recent times who deserved to be called a statesman. Raúl Alfonsín, a lawyer and lifelong Radical politician who died on March 31st at the age of 82, was justifiably seen as the father of his country's current period of democracy. His victory in a presidential election in 1983 not only marked the end of the region's most vicious military dictatorship, during which at least 9,000 Argentines "disappeared". It also marked the first time the Peronist movement was defeated in a free election.

Mr Alfonsín won widespread praise for putting the dictators on trial (some were jailed) as well as setting up a truth commission into the political violence and repression of the 1970s. It helped that Argentina's humiliation in the Falklands war had discredited the generals. But when several coup attempts followed, Mr Alfonsín felt he had no option but to halt further trials. That was partly because he had been weakened by his mishandling of the economy. An old-fashioned populist, he failed to understand that drastic reform was needed. When hyperinflation culminated in disorder and looting, he stepped down five months before the end of his term.

His successor, Carlos Menem, a Peronist, would carry out the free-market reforms he had eschewed. In ill-judged secret talks, Mr Alfonsín negotiated political reforms in return for a constitutional change that allowed Mr Menem to run successfully for a second term. But perhaps Mr Alfonsín's biggest mistake after leaving office was not to allow others to take charge of his party. His meddling undermined the presidency of another Radical, Fernando de la Rúa, who also failed to finish his term when the economy collapsed in 2001. Though the Radicals shrivelled and splintered around him, he clung on as their leader.

There was nonetheless a decency about Mr Alfonsín that marked him out. He believed in institutions. He was the only recent president not to pack the Supreme Court with friends. He was not corrupt. In death, he was praised across the spectrum. His democratic idealism seems to have moved a generation too young to remember his presidency. Thousands of ordinary Argentines waited with flowers and tears to pay their respects as his body lay in the Congress building. He had many flaws, but his virtues are sorely missed by his troubled country.

India's election

Congress's great dynastic hope

Apr 2nd 2009 | WARDHA
From The Economist print edition

Rahul Gandhi, progeny of prime ministers, kicks off his campaign for India's general election

AFP

TO THE buzz of an approaching helicopter, 30,000 people arise in Wardha, in the dead centre of India, and start waving at the sun-bleached sky. Rahul Gandhi—the 38-year-old heir to India's great political dynasty; son, grandson and great-grandson of prime ministers; and leader in waiting of their Congress party—is coming.

On landing, in an ugly yellow dust-storm, Mr Gandhi climbs a small dais and, after some little-heeded words from Congress's chief minister of Maharashtra, opens his campaign for the general election that is due to begin on April 16th. Speaking in a soft voice, and with deliberate, north-Indian-accented Hindi, he promises to fight poverty and for national unity. He makes bold claims for the outgoing Congress-led coalition government—especially for several welfare schemes that it has launched, including a massive debt write-off for small farmers. The crowd is hushed. In a desiccated cotton-growing region of Maharashtra, where rates of indebtedness and suicide among farmers are high, this was a popular measure.

Then "Jai Ho!"—the Oscar-winning theme-track to the film "Slumdog Millionaire", which Congress has adopted for its campaign—blares through the speaker. And Mr Gandhi is up and off. Within 20 minutes, but for a few children combing for plastic water-bottles and other sellable rubbish, the rally-ground is empty.

This is a hopeful election for Congress, India's closest approximation to a party with national appeal. Led by Mr Gandhi's mother, Sonia Gandhi, and her chosen prime minister, Manmohan Singh, it has presided over a coalition government for the first time—and more skillfully than many expected. Coinciding with a run of unprecedentedly high economic growth, which provided bumper revenues for the open-handed schemes that Mr Gandhi boasted of, it also seems less unpopular than outgoing Indian governments often are. Because of this, and the weakness of its main opponent, the Hindu-nationalist Bharatiya Janata Party (BJP), Congress seems to have a decent chance of retaining power, at the helm of another coalition.

Buoyed by its success, the party that led India for three decades without a coalition is even dreaming it may one day do so again. Under Sonia Gandhi, who took over in 1998, seven years after her husband Rajiv was assassinated, it hopes to have arrested its long decline. At the last election, in 2004, it won 145 of India's 543 parliamentary seats; in 1999 it won only 114. Under Rahul Gandhi, who lacks his mother's handicap of foreign (Italian) birth, Congress plans to rebuild its eroded base.

It has therefore spurned possible electoral alliances in the populous northern states it once dominated, and which it must regain if it is to win a parliamentary majority. On March 21st Congress announced it would follow this strategy in Bihar, where it won just three of a possible 40 seats in 2004. This will mean fighting against two coalition allies, a party dedicated to low-caste Hindus and another to dalits,

Hinduism's former "untouchables", that it will again want support from after the election. And on March 26th, the Samajwadi Party, which Congress had been negotiating a pact with in Uttar Pradesh (UP)—a state where it won 12 of 80 seats in 2004—said negotiations had failed because of Congress's excessive demands.

This is a risky strategy, with Congress counting on winning enough seats to take the lead in forming a coalition, which its currently-piqued allies will then join. In the longer-term, it hopes that fighting alone in Bihar and UP will begin the process of rebuilding there, which Rahul Gandhi will lead. If Congress does retain power in the election, which will run until May 13th, many would expect him to take over as prime minister within a year or so from Mr Singh, who is 76 and frail.

Given that Congress stood to gain only a dozen or so extra seats from electoral tie-ups in UP and Bihar, its gamble looks reasonable. Fighting the election unencumbered will also give it a wider choice of allies after the poll, in which several of its erstwhile allies may fare poorly. For alternative—or additional—partners, Congress may have its eye on one or two current friends of the BJP. Underpinning its strategy, indeed, is a calculation that even if the Hindu nationalists win more seats than Congress in the election, they would be less able to build the necessary coalition.

Several former BJP allies—including the biggest prop of the former BJP-led government, Andhra Pradesh's Telugu Desam Party—consider their association with the Hinduist party to have cost them crucial Muslim votes. And the BJP's prime-ministerial candidate, L.K. Advani, is more divisive than his predecessor, Atal Behari Vajpayee. To reassure potential allies—and the many secular Indians who share its free-market agenda—the BJP is therefore trying to downplay its Hindu-chauvinist one. But this irks the party's saffron-hued base.

A controversy stirred by Mr Gandhi's estranged 29-year-old cousin, Varun Gandhi, who is standing in UP for the BJP, illustrates its dilemma. On March 16th a television news channel broadcast a recording of a speech in which Varun promised India's 160m Muslims that he would "cut their throats after the election". He has since been arrested and charged with attempted murder and other crimes. To appease the party's livid stalwarts, Mr Advani has felt the need to back Varun's claim to have been mis-recorded. He has also promised to campaign on Varun's behalf. Meanwhile, an important BJP ally, Nitish Kumar, has said Varun must be prosecuted.

Congress's more distant hope—for a national revival under Rahul Gandhi—looks dicey. Its Gandhi cult unites a party that would probably fracture without it, as happened after Rajiv Gandhi's death. Yet Congress's relentless shrinkage under Gandhi leadership—including in the last election, when its overall vote-share actually fell—is evidence of the family's diminishing appeal. It will take more than a new Gandhi to woo many people back from regional and caste-based parties, which are more obviously devoted to dispensing the patronage poor Indians crave.

Mr Gandhi, who can seem an awkward politician, though he is clearly well-intentioned and no fool, knows this. In an interview in Delhi on March 30th, the day before he launched his campaign in Wardha, he was keen to discuss his ambitions—and fledgling efforts—to make Congress more democratic. His vision is a party in which "it doesn't necessarily matter who your mother is or who your father is but how many supporters you have in the district." That would be good, and may one day transpire. But if Congress wanted to be like that now, as Mr Gandhi must also know, he would not be about to inherit it.

Pakistan

The war on Pakistan's Taliban

Apr 2nd 2009 | LAHORE
From The Economist print edition

Stalking Baitullah Mehsud

AP

The battlefield in Lahore

IT WAS a rare success for Pakistan's police. At dawn on March 30th, a group of grenade-hurling, Kalashnikov-wielding terrorists, some in police uniform, stormed a police training centre in a rural suburb of Lahore, seizing the compound with over 800 cadets. By 4pm, it was all over. Four terrorists were killed or blew themselves up. Three were captured. The police fired wildly in the air before cameras as the captives were whisked away.

Less than a month before, a similar group had brazenly attacked a bus carrying the Sri Lankan national cricket team in Lahore. After that bloody episode, in which all the terrorists escaped leaving eight policemen dead and a couple of cricketers wounded, many pointed the finger of blame at India, with which Pakistan has been locked in conflict since 1947. This time, the de facto interior minister, Rehman Malik, looked elsewhere. “Their footprints lead to Waziristan,” he said—referring to Baitullah Mehsud, a jihadist warlord who maintains a fief in that north-western region on the border with Afghanistan.

Mr Mehsud leads a loose coalition of warlords and militias known as the Tehreek i Taliban Pakistan, or the Pakistan Taliban. He has been blamed for many recent terrorist attacks, including the assassination in Rawalpindi in December 2007 of Benazir Bhutto, a two-time former prime minister. He has since expanded his Pushtun-dominated network to include jihadist groups from Pakistan's Punjab province, including one or two disgruntled outfits who had previously fought as proxies of Pakistan's army in Indian-held Kashmir.

Al-Qaeda has also found a refuge in Mr Mehsud's borderland fief, which America has peppered with missile strikes. Last week, America put a $5m bounty on Mr Mehsud's head and, in vain, dispatched its missiles to kill him.

Mr Mehsud is unabashed. He called the BBC from his hideout to declare that “by the grace of Allah Almighty, I am claiming responsibility for the attack on the police training school in Lahore with eagerness, honour and love and will continue similar strikes across the country if the US drones are not stopped from killing innocent people in the tribal areas.” Now it remains for America to stop him. Pakistan's army seems unable to do so. In private, it says it has been asking America to kill him for months. Yet officially it objects to America's missile strikes and, in Waziristan itself, it is observing an on-off ceasefire agreement with him.

Afghanistan and Pakistan

More troops and money

Apr 2nd 2009 | THE HAGUE
From The Economist print edition

But the same old problems

Illustration by Claudio Munoz

THE opening move of Barack Obama's campaign against the Taliban and al-Qaeda was as successful as he could have wished. Just days after he unveiled a new policy to deal with extremists on both sides of the Afghanistan-Pakistan border, nearly 90 countries and international bodies gathered in The Hague to support him.

Delegates hailed the "renewed", "rejuvenated" or "re-energised" American effort after seven years of ever more costly and dispiriting fighting. The most closely watched participant was Iran, the object of American courtship. It announced that, despite its dislike of the "ineffective" foreign forces in Afghanistan, it was "fully prepared" to help fight drugs-trafficking and rebuild Afghanistan. And Russia, with whom America wants to "reset" testy relations, said it could do more after allowing America to send non-military supplies to Afghanistan through its territory (France and Germany can send military kit).

The conference in The Hague began prosaically, as a forum to discuss Afghanistan with troop contributors and donors excluded from NATO's 60th-anniversary "family only" summit on April 3rd-4th. It quickly turned into a display of the Obama administration's new consultative approach to international problems.

But if conferences and words could win a war, the Taliban would have been defeated long ago. Can the new strategy work any better than the previous one? For Mr Obama, the Pakistani side of the lawless Pashtun belt poses the biggest threat to global security. The most senior Taliban and al-Qaeda leaders are ensconced there, and they must not be allowed to retake power in Afghanistan. Iraq has diverted America's attention, money and troops; these must now be redirected to what American officials call "Af-Pak".

Mr Obama's "comprehensive" strategy, unveiled on March 27th, borrows much from George Bush's "surge" in Iraq: military reinforcement; strengthening government and the economy; building large local security forces; wooing "reconcilable" insurgents; seeking wider support.

But much of this has been tried in Afghanistan already. Kai Eide, the United Nations envoy in Kabul, says "the time for strategic debate must come to an end"; now it's time for implementation. This is where Mr Obama can make a difference. He has ordered the deployment of 17,000 more troops, along with 4,000 military trainers. The Afghan army will expand to 134,000 by 2011; the 80,000-strong police will be better trained; both will probably grow bigger thereafter, depending on the funds available and the Taliban's strength.

Mr Obama is not asking allies for many more troops (though they are needed), focusing instead on requests that may be more palatable: more money, police trainers and civilian experts. And, in an attempt to secure more Muslim support, Gulf states are being asked for similar help.

All this still seems well short of what many generals think is needed for an effective counter-insurgency campaign. But one hope is that, if America can reverse the Taliban's momentum in the next fighting season, some insurgents may start to switch sides. For now "reconciliation" seems limited. It would exclude senior Taliban leaders such as Mullah Omar, deemed "irreconcilable". The Obama team, for its part, accepts it will have to deal with President Hamid Karzai despite its strong criticism of his failure to curb corruption; Hillary Clinton, the secretary of state, praised his "critical leadership role". America now

proposes a “compact” with Mr Karzai that would set unspecified “benchmarks” for better performance.

America’s attention has shifted from Afghanistan to the Pakistani side of the border. Like Mr Bush, Mr Obama keeps up drone and guided-missile strikes on “high-value targets” in Pakistan’s tribal belt. If anything, Mr Obama has expanded the targets to include not just al-Qaeda’s foreign fighters but also members of the Pakistani Taliban. On April 1st, a missile fired at a Taliban compound in Pakistan is reported to have killed 12 people.

In a swipe at Mr Bush’s policy in Iraq, Mr Obama says “we will not blindly stay the course”. But now that he has made Af-Pak his war, Mr Obama will face the same dilemma as Mr Bush did: if his military campaign fails, does he give up or persevere? He will not easily be able to abandon a region that, in his own words, is “the most dangerous place in the world”.

Economist.com WORLD ASIA

The Khmers Rouges and justice

The court on trial

Apr 2nd 2009 | PHNOM PENH
From The Economist print edition

Accusations of corruption threaten to discredit the trial of the Khmers Rouges

THE tribunal to try former Khmers Rouges began its real proceedings this week. The first in the dock is Kaing Guek Eav, alias Duch, who ran the former regime's notorious S-21 torture prison and who is charged with crimes against humanity, torture and murder. In court, he admitted responsibility, expressing "heartfelt sorrow". But the long-overdue hearing is being overshadowed by accusations of a lesser sort: corruption and political interference. These threaten to discredit proceedings on the far greater crimes.

Three of the court's staff, who spoke on condition of anonymity, accuse Sean Visoth, the court's chief of administration, of collecting money from every Cambodian in his department, including court employees and Cambodian legal assistants in the office of the co-investigating judges and co-prosecutors (the court has dual officials because it is was set up under Cambodian and United Nations auspices and is run under national and UN rules). Some of the cash, they were told, was intended for Sok An, a deputy prime minister.

There is no indication that the minister took the money and neither man has commented on the accusations, which are unproven. But in November Sean Visoth went on sick leave because, according to the government's spokesman Khieu Kanharith, a UN corruption review had named him and requested his removal. "Sick leave is a political excuse," he says.

These accusations are only the latest in a series to have plagued the court. The UN says that last year it received complaints from several Cambodians about kickbacks. This action brought the UN and Cambodian sides into conflict and, according to one staffer at the court, resulted in several people being fired by the government in murky circumstances.

The court's rules oblige Cambodians to report complaints to their own government. So when the Cambodian whistle-blowers took their complaints to the UN, it organised a confidential review of the allegations and recommended that the Cambodian side should investigate them. The Cambodian side responded by saying that the review was outside the UN's jurisdiction and therefore invalid. Last August Sok An appointed two officials to hear the complaints and in December he met officials of the UN Office of Legal Affairs to draw up an anti-corruption plan. But the whistle-blowers are not reassured. "If the UN does an investigation, I will come out," says one. "But if the government does an investigation, I will not…I would not feel safe for myself and my family."

Lawyers for the defence are demanding a full investigation. On March 27th the defence team for Nuon Chea, another of the accused, backed by two other defence teams, asked to see the confidential UN review. "At some point," says Richard Rogers, the co-ordinator for the defence lawyers, the UN "is going to have to choose between either looking like it's complicit in a cover-up or hand over the documents to the defence teams so they can help ensure international standards."

There are also allegations of political interference, not just corruption. The international prosecutor, Robert Petit, says he has enough evidence to charge more suspects than the five in detention. Yash Ghai, a former special representative of the UN secretary general to Cambodia, adds that if prosecutors have enough evidence to prosecute "they have a duty to do so." But the Cambodian prosecutor disagrees. Pursuing more suspects would cause instability and exhaust funding, she argues.

Such disputes may be inevitable in a process that is designed to please both Cambodia, which is concerned about maintaining political support for the trial, and the UN, which must keep up international legal standards. "It's very easy to be a pure international judge in a pure international tribunal very far away from Cambodia, far away from this corrupt atmosphere," says Marcel Lemonde, the court's international co-investigating judge and a framer of its internal rules. "But if we have the court operating in Cambodia, applying Cambodian law, with participation of Cambodian judges, and the possibilities for

victims and witnesses to attend the hearings and participate, then it becomes interesting."

The rumble of allegations makes it increasingly difficult for the court to satisfy both sides. The UN Development Programme, which manages a trust fund of donations to the court, has refused to pay the Cambodian side, pending the result of the corruption investigation. Other donors are likely to continue their support—unless the UN itself pulls out or the international judges rule to stay proceedings.

Even then, says the Cambodian government, the trial would go ahead. "Why don't all the lawyers pull out?" asks its spokesman. "If you say that the court is corrupt, get out. At least we can save some money." But not, if that were to happen, the tribunal's judicial reputation.

Thailand

No green light

Apr 2nd 2009 | BANGKOK
From The Economist print edition

Back to the barricades

EPA

Thaksin sounds the red alert

TRAFFIC lights go from red to yellow. Thai politics goes the other way. Last year it was the “yellow shirts” of the royalist People’s Alliance for Democracy (PAD) who stormed the prime minister’s compound, bringing the country to its knees and forcing the government out. Now, after a few months’ calm, tens of thousands of redshirted protesters are surrounding the compound, demanding the resignation of the prime minister, Abhisit Vejjajiva, and holding up portraits of Thaksin Shinawatra, the twice-elected prime minister deposed by the army in 2006.

A wealthy fugitive from Thai courts, Mr Thaksin flits between bolt holes, offering himself as a CEO-style leader who will return to save the nation from economic calamity. “I will do magic for you,” he coos. A dubious offer, no doubt, for a country that has already lost three years to political turmoil and military misrule. But it is a measure of the economic discontent fuelled by worldwide recession, and the anger and disgust at Mr Abhisit and his military backers, that such rhetoric is wildly popular.

Mr Abhisit has prudently kept out of sight, attending the G20 summit in London on behalf of the Association of South-East Asian Nations (ASEAN). In his absence, the deputy prime minister, Suthep Thaugsuban, offered to hold talks with Mr Thaksin. But any demands for snap elections would not be on the table, he added.

Thai politics is becoming a grudge match. On March 27th Mr Thaksin accused Prem Tinsulanonda, the chief adviser to King Bhumibol, of helping to instigate the 2006 coup, together with Surayud Chulanont, another adviser who became prime minister. Both men deny the charges. More broadly, Mr Thaksin accuses the Thai aristocracy of suppressing democracy and urges his followers, who are largely lower middle-class, to rise up and reclaim their rights. In using such class-war rhetoric, Mr Thaksin is playing with fire. And by sniping at Mr Prem, the chairman of the Privy Council, he is breaking Thailand’s royal taboo, Mr Thaksin’s pledges of loyalty to the crown notwithstanding.

Privy Councillors serve at the king’s discretion so urging them to quit in shame is widely seen as a “half step” from directly challenging the monarch, says Thitinan Pongsudhirak, a political analyst. The latest round of street demonstrations could take the endless feuding of Thai politics to a new, more dangerous level.

South Korea

Mad bullying disease

Apr 2nd 2009 | SEOUL
From The Economist print edition

Press freedom under attack

NORTH KOREA this week detained a South Korean man for criticising Kim Jong Il's regime and "trying to lure a female North Korean" south. No surprise there. More strikingly, across the border, South Korean prosecutors last week arrested a producer at the country's second-biggest television station, Munhwa Broadcasting Corporation (MBC), and four union members at a 24-hour TV news channel, YTN.

Lee Choon-keun, a producer at South Korea's best known investigative television programme, PD Notebook, spent 48 hours in jail after a former agriculture minister and his deputy accused the programme of slandering them in April 2008. The programme had asked whether American beef was free from mad-cow disease. The prime minister, Han Seung-soo, says the information was misleading and "led Korea into chaos" by sparking vast street demonstrations against the government's decision to resume imports of American beef. Arrest warrants are out for five other PD Notebook journalists. Some MBC employees are sleeping in the station's lobby to prevent police from seizing their videotapes and notes.

At YTN, the leader of its union, Roh Jong-myun, and three others were arrested for obstructing the president, Gu Bon-hong, from entering his office. YTN's union feared that Mr Gu, who was appointed to his post by the government last year, would undermine the station's editorial independence. Nearly half the channel's employees went on strike because of Mr Roh's detention, though the dispute was settled this week. Amnesty International claims his arrest was part of "an increasingly concerted effort by the government to control South Korea's media". It says that last year the heads of four other media groups—the state-owned Korea Broadcasting System (the country's largest television station), Korean Broadcasting Advertising Corporation, Arirang TV and Sky Life—were replaced by government supporters.

The ruling Grand National Party is now debating whether to make it a crime to post inaccurate or misleading information on the internet. A blogger, Park Dae-sung, was arrested in December after being rude about the government's economic management. He is still in jail. "Every journalist in South Korea is fearful right now," says PD Notebook's Mr Lee.

South Africa

Politics versus the law

Apr 2nd 2009 | JOHANNESBURG
From The Economist print edition

What Jacob Zuma's tortuous legal battles reveal about the country's courts, judges, politics—and its likely next president

Illustration by Peter Schrank

THE National Prosecuting Authority (NPA) looks set to drop all charges of corruption, racketeering, tax evasion, money-laundering and fraud against Jacob Zuma, leader of the ruling African National Congress (ANC). But whether it does or not, he is still pretty sure to become South Africa's next president after this month's general election, when the new parliament then elects the head of state. That may end a legal drama that has captivated the country for the past eight years.

But what would it say about the independence of the criminal-justice system? Some may argue that it will have succumbed to political pressure and that democratic South Africa may go the way of other postcolonial African states dominated by self-serving liberation movements. Others are more hopeful.

From the outset, Mr Zuma, the country's deputy president until he was sacked in 2005 by its then president, Thabo Mbeki, has claimed to be the victim of a political conspiracy aimed at blocking his chances of becoming president. Now the NPA is reported to have received firm evidence of collusion between its former officials and Mr Mbeki in prosecuting a man who was one of his closest friends and colleagues for three decades but whom he had come to regard as his most dangerous rival.

Yet evidence of a plot against Mr Zuma, who has always denied all charges, does not necessarily mean he is innocent. As Louis Harms, deputy chief judge of the Supreme Court of Appeal, said in January when he overturned a lower-court ruling that had quashed charges against Mr Zuma on technical grounds, "a prosecution is not wrongful merely because it is brought for an improper purpose. It will only be wrongful if, in addition, reasonable and probable grounds for prosecuting are absent." If it is to preserve its integrity and that of the justice system, the NPA has to show that this indeed was the case.

On the face of it, the case against Mr Zuma, who has presided over the ANC since defeating Mr Mbeki for the party post just over a year ago, looks grave. Yet when his friend and financial adviser, Schabir Shaik, was charged in 2003 with corruption and fraud over a $5 billion government arms deal, the NPA

announced oddly that, though it had a “prima facie” case against Mr Zuma, it did not feel it had a “winnable case”, so it would not prefer charges. That prompted immediate suspicions of political interference—at that time in favour of Mr Zuma.

Two years later Mr Shaik, controversially freed last month on medical parole after only two years behind bars, was jailed for 15 years after being found guilty of, among other things, giving Mr Zuma more than 1m rand (then worth $165,000) in bribes and of negotiating a further payment of 1.5m rand from a French arms company. Mr Zuma was promptly sacked as Mr Mbeki’s deputy before being charged in turn. But even then the NPA did not seem to have enough evidence against him and when, 15 months later, it asked for yet another postponement of the trial, the courts threw the whole case out.

But the matter did not end there. In December 2007, ten days after Mr Mbeki was ousted as the ANC’s leader, new charges were brought against Mr Zuma in relation to alleged bribes totalling more than 4m rand that he was accused of taking between 1995 and 2005 in connection with various business deals, not just the arms contract. Nine months later these charges were thrown out too, on the ground that the NPA had not invited Mr Zuma to give his side of the case before recharging him, thus violating his rights.

Zooming into power

That was not, however, the part of the court ruling that caught the public eye. Rather it was the judge’s electrifying assertion that the whole case appeared to have been subject to a “baleful political influence”. It was a “matter of grave concern”, he said, that such interference in the criminal process had taken place “in the new South Africa, given the ravages it caused under the apartheid order.” Those observations, later condemned by the Supreme Court of Appeal as “inappropriate”, were seized upon by Mr Zuma’s people, now in charge of the ANC’s ruling body, as a reason for dumping Mr Mbeki as South Africa’s president.

Several points emerge from this sorry tale. Whether or not the NPA was nobbled, the judges continued to hand down robust judgments based solidly on the law. Despite ferocious attacks on their integrity, often by Mr Zuma’s supporters, and even death threats, they have stood firm.

Under apartheid, South Africa’s courts were part of a highly repressive system, yet many judges earned a reputation for fairness and intellect. On the eve of the first truly democratic elections in 1994, only three of the 166 judges in the country’s higher courts were black. Today, non-whites account for nearly half the 200-plus judges in those higher courts. Most of the newcomers are doing a good job. South Africa’s judiciary is widely respected.

Another friend in need

But not all the newcomers are held in high regard. Last year John Hlophe, president of the Western Cape’s High Court, was suspended after he was accused of approaching two judges on the 11-member Constitutional Court in an alleged attempt to influence the outcome of one of the cases pending against Mr Zuma. The court lodged a complaint with the Judicial Services Commission, the judges’ independent disciplinary body. Mr Hlophe, who is close to Mr Zuma and has been tipped as a possible replacement for Chief Justice Pius Langa, hit back, accusing the judges of breaching his right to dignity and equality.

On March 31st the Supreme Court of Appeal rejected a case brought by Mr Hlophe against the Constitutional Court judges, finding that they had not acted unlawfully; he is still suspended. This may not, however, stop his elevation to the highest court in the land, when three of its number step down in October. It will be up to Mr Zuma, if elected president, to appoint their replacements from a shortlist provided by the Judicial Services Commission. Despite his supporters’ antics, he says he supports an independent judiciary as “one of the pillars of our peaceful, stable and orderly co-existence”. But he also calls for an “accelerated transformation of the entire court system”.

A recent opinion poll suggests that the stream of accusations and leaks against Mr Zuma has led many South Africans to conclude that he is no angel. He makes whites, who comprise less than a tenth of the electorate, distinctly queasy. But the same poll also suggests that his popularity is undented, at least among blacks, who still seem to support him overwhelmingly. For the poor majority in South Africa it is bread-and-butter issues, such as housing, health and education, that matter most, not the niceties of the law.

A mysterious air raid on Sudan

A battle between two long arms

Apr 2nd 2009
From The Economist print edition

The shadow-boxing between Israel and Iran moves from Gaza to Sudan

GIVEN the ferocity of Israel's onslaught on the Islamist militants of Hamas in the Gaza Strip in the first three weeks of January, it stands to reason that Israel would also be doing everything in its power to stop them getting more weapons. Only now is a murky story emerging of how far (about 1,400km, or 870 miles) Israel was prepared to go.

"Who needs to know, knows," said Ehud Olmert, Israel's outgoing prime minister, thereby tacitly confirming a flurry of media reports that Israeli aircraft and/or unmanned drones had destroyed a convoy of 23 lorries carrying Iranian arms destined for Hamas in mid-January in north-east Sudan. After some confusion, the Sudanese government admitted that such an attack, "probably" by Israel, had indeed taken place just north of Port Sudan on the Red Sea. Exotic but unverifiable claims in various media aver that Israel's Mossad intelligence service got a tip that the arms were going to be smuggled into the Gaza Strip via Sudan and Egypt; that Israel's air force had only a few days to prepare its raid; and that 40 or so people in the convoy, including Iranians, may have been killed.

Israel's aim is said to have been to stop Hamas acquiring Iranian Fajr rockets, designed to be stripped down and carried in parts through the tunnels from Egypt into Gaza, from where their range of at least 40km would have given Hamas a longer reach than its homemade Qassam rockets or the Grad rockets it has already smuggled in and fired at Israel. A secondary aim may have been to remind Iran of Israel's own "long arm", and that Israel may one day dare to use it against Iran's nuclear programme. In September 2007, in another raid Israel confirmed only by nods and winks, it destroyed what America said later was a secret nuclear reactor being built with North Korean help in Syria.

Iran and Sudan have had close links ever since Sudan's Islamic revolution of 1989, which brought the present government of Omar al-Bashir to power and was inspired by the Iranian version a decade earlier. Hassan al-Turabi, the Islamist ideologue who organised the coup that installed Mr Bashir, explicitly sought a Sunni version of Iran's Shia revolution, complete with Revolutionary Guards, severe dress codes and *sharia* courts. Mr Turabi hoped to cast himself as an Ayatollah Khomeini of east Africa.

Despite doctrinal differences between the two countries, Iran swiftly recognised a useful ally in an unfriendly neighbourhood. As a token of friendship, Iran's then president, Akbar Hashemi Rafsanjani, visited Khartoum in 1991, along with no fewer than 157 officials. Under agreements signed during Mr Rafsanjani's visit, Iran agreed to help train Sudan's version of the Revolutionary Guards, the Popular Defence Forces. To this end Hassan Azda, an Iranian who had been training Hizbullah fighters in Lebanon, was posted to Sudan in 1992.

Iran also helped to set up Sudan's fledgling arms industry, now the third-largest in Africa. The missiles that Israel is said to have destroyed in the January raid were probably shipped into Port Sudan via Yemen from Iran. But it is also possible that some of the arms were manufactured not in Iran but in Sudan's own military-industrial complex south of Khartoum. The Iranian defence minister spent four days in Khartoum last year, where he signed another co-operation agreement "in the fields of military technology and the exchange of expertise and training", according to a Sudanese newspaper.

Apart from technical help, Iran and Sudan support each other in diplomacy. The Sudanese have backed Iran in its confrontation

with the United Nations over its nuclear programme, and Iran has supported President Bashir in his own confrontation with the International Criminal Court at The Hague, which wants him arrested for alleged war crimes in Darfur. Israel's raid, however successful in stopping the convoy bound for Gaza, will have done nothing to weaken, and may have strengthened, the bond between these two governments.

Israel's electoral system

Make it better

Apr 2nd 2009 | JERUSALEM
From The Economist print edition

Too many parties, too many ministers

AS THEY set about building a government coalition in mid-February, many of Israel's politicians proclaimed a need for electoral reform. The latest election, they said, amply proved their point, with 12 parties winning seats in the 120-strong Knesset, Israel's parliament. The largest one, Kadima, won a mere 28 seats—and proved unable to form a government. This week Binyamin Netanyahu, whose right-wing Likud came second with 27 seats, was formally installed as prime minister. But the coalition he heads, endorsed by some 74 members of the Knesset, is unwieldy—and could easily fall apart. Yet few Israelis would bet on new electoral laws being enacted in the coming four-year term.

Thirteen of Mr Netanyahu's Likud lawmakers are now ministers. After handing out most of the top jobs to his coalition partners, he has had to fiddle with existing departments to create new ministries, some with rather vague remits, for some of his Likud colleagues. "Deputy prime minister and minister for intelligence and atomic energy" is one new title. But no head of Mossad, the external security service, has ever reported to anyone other than the prime minister, says a former Mossad chief. Another Likud loyalist has become "minister without portfolio responsible for improving the government's services to the citizen".

Mr Netanyahu made his name in politics as a fiery reformer in the early 1990s, when huge demonstrations prompted the politicians to change the system. But the reform failed, giving reform itself a bad name. Anyway, says Arye Carmon of the Israel Democracy Institute, people are too jaded now to take to the streets. A string of corruption scandals has brought all of politics into disrepute. The civil service has gained more power behind the scenes. The Knesset has been debased by the executive's greater clout. With so many coalition members serving as ministers and deputy ministers, there will be too few backbenchers to give the government majorities in all of the Knesset's 17 committees.

Daniel Friedmann, a law professor who served as justice minister in the outgoing government, has fired off a bright new idea before leaving. Go back to the reformed system briefly tried in the 1990s, he says, in which voters cast two ballots, one for prime minister and the other for the party of their choice. He now also suggests giving the victorious prime minister a bonus of, say, ten Knesset seats before allocating the other 110, to make governments easier to form and more stable once in office.

Another ploy would be to raise the threshold for parties to get seats on the prevailing list system from the current low one of 2%, which is one reason for a plethora of parties being represented—and why coalition-builders find themselves in hock to tiny ones. But small parties would almost certainly refuse to pass a reform that might knock themselves out. And the larger ones, such as Kadima and the Likud, are not big enough to club together to push a wider electoral reform through.

Saudi Arabia's Prince Nayef

A rising but enigmatic prince

Apr 2nd 2009 | CAIRO
From The Economist print edition

Could a tough interior minister be a reforming king?

Reuters

THE many palaces of Riyadh, Saudi Arabia's desert capital, are not as colourful as the Kremlin. But it can be as hard to unravel the politics played out behind their walls as it was for interpreters of Soviet Russia. Amid the swirl of rumour, news of real shifts occasionally wafts out, as it did on March 27th, when King Abdullah appointed his half-brother, Prince Nayef, as his second deputy prime minister.

The title does not sound very grand, considering the 75-year-old prince's service as the powerful interior minister for a cool 34 years. But the 84-year-old king happens also to be Saudi Arabia's prime minister. His first deputy and anointed successor, Crown Prince Sultan, has been abroad for months, convalescing from cancer.

In the past, second deputy prime ministers have been considered second in line to the throne. King Abdullah had left the post vacant since assuming the throne in 2005. In this light, Prince Nayef's sudden appointment may amount to more than just finding someone to keep house while the king travels to the G20 meeting in London. If Prince Sultan, who is in his 80s (and who has been defence minister for 46 years), were to die first and the king then followed him rapidly to the grave, Prince Nayef would, by the latest rule, take the crown.

Saudologists have long speculated over who might follow the ailing Sultan as named successor to the rule of a country that holds a quarter of the world's oil reserves. By tradition, kingship has passed between brothers of one generation of the Al Saud family before descending to the next. The trouble is that half of the 35-plus sons of the country's founder, Abdul Aziz ibn Saud, who died in 1953, are still alive. Some are neither capable nor ambitious enough to be king. The remaining contenders include several full brothers of Prince Sultan. Known as the Sudairis after the family of their mother, these princes, among them Nayef, have long dominated the defence and interior ministries.

The creation by King Abdullah two years ago of a family council representing all of Abdul Aziz's sons, which was charged with approving future heirs to the throne after Crown Prince Sultan, was widely seen as a manoeuvre to bypass the Sudairis' overweening influence. But his elevation of Prince Nayef appears now to consolidate their power.

As interior minister, Prince Nayef is credited with Saudi Arabia's relative success at curbing radical Islamist terrorist groups. The local branch of al-Qaeda staged numerous bloody attacks in the kingdom between 2003 and 2005, but appears to have been sorely weakened by a concerted police campaign of arrests, co-option and public relations. Prince Nayef's long career as security chief also has darker chapters. Aside from his arbitrary imprisonment of dissidents, including liberals as well as religious radicals, and his imposition of often petty forms of censorship on the press, the interior minister is known for extreme conservatism on issues such as political reform and the rights of women and religious minorities.

"If he became king, our feeble hopes for reform are finished," declares a commentary on an opposition website popular among the kingdom's Shia minority, which makes up 10% of its people. Some attribute the prince's promotion to fears among the Al Saud of growing unrest among Shias, who complain of widespread discrimination. This may not bode well for peace in the kingdom. But others assert that, given the deep religious conservatism of Saudi Arabia's Sunni majority, Prince Nayef's reputation for toughness may actually allow him to push more strongly for reform than the current, mild-mannered king, whose efforts in this regard have been halting.

The Arab League summit

Unity of a kind

Apr 2nd 2009 | CAIRO
From The Economist print edition

No agreement, except to express Arab solidarity for an indicted war criminal

SINCE its founding in 1945, the Arab League, now embracing 22 countries (including Palestine), has sought to forge unity. Yet its annual summits have tended to produce either quarrels or platitudes. The latest gathering in the Qatari capital, Doha, followed much the same pattern but did produce unity—of a sort. Independent Arab commentators, as opposed to the state-controlled media, were united in calling it a waste of time.

“The only use of summits,” said Salama Ahmed Salama in Egypt’s daily, *al-Shorouk*, “is that they sharpen trends of rejection and opposition to these regimes.” “The only novelty they bring is new divisions,” chimed Abdel Bari Atwan, editor of *al-Quds al-Arabi*, a daily published in London. “Rising non-Arab powers in the region, such as Iran and Turkey, rub their hands in glee at the spectacle,” he asserted.

With 17 heads of state in attendance, the meeting did agree on one thing, however. Fellow Arab leaders rallied around Sudan’s president, Omar al-Bashir, in a chorus of condemnation against the International Criminal Court in The Hague, which has ordered his arrest on charges of organising the extermination, rape and forcible transfer of a large part of the civilian population of Darfur. Delegates denounced the court for picking on Arab and Muslim leaders while ignoring the alleged crimes of Israel. Syria’s president, Bashar Assad, said the court had no right to interfere in countries’ sovereign affairs—an understandable complaint, as a UN tribunal is investigating Syria’s likely involvement in a series of political murders in Lebanon.

But the summiteers skirted issues that have lately divided them. The Arab leaders said little about Iran, the non-Arab regional heavyweight allied to Syria but regarded with suspicion by other Arab leaders because of its nuclear ambitions, its championing of Islam’s minority Shia branch, and its backing for non-state actors such as Hizbullah in Lebanon and Hamas in Palestine.

On the Arab-Israeli conflict, the Syrian president drew nods of approval by complaining that, since offering a peace initiative in 2002, the Arabs had yet to find an Israeli partner and may fail to find one in Israel’s new government led by Binyamin Netanyahu. They reiterated the peace offer that calls for Israel to withdraw from all the land it has occupied since the 1967 war in exchange for full Arab recognition. But while suggesting that a precise time limit be tied to the offer, it declined to set one.

As usual, the meeting was enlivened by the longest-serving Arab ruler, Libya’s flamboyant Muammar Qaddafi, who mumbled insults at King Abdullah of Saudi Arabia from behind his wraparound sunglasses. The two later met to heal their rift, which began in 2003 when the king insulted Mr Qaddafi after the exposure of a Libyan plot to kill him.

But the meeting failed to resolve the biggest current row between leaders. Egypt’s Hosni Mubarak, whose ancient and populous country once dominated inter-Arab diplomacy, disdained to travel to Qatar, reflecting intense irritation with diplomatically hyperactive Qatar. Aside from hosting exiled foes of Mr Mubarak, the tiny, gas-rich emirate sponsors the al-Jazeera TV channel, which often ridicules Egypt’s 80-year-old leader and backs the Muslim Brotherhood, his main opposition.

Iraq's former insurgents

Bad blood again

Apr 2nd 2009 | BAGHDAD
From The Economist print edition

The government must act quickly to keep former rebels on its side

SOME of the heaviest fighting in Baghdad since 2007 erupted on March 28th after former Sunni insurgents, who were supposed to have come "on side", clashed with Iraqi soldiers who had arrested one of their leaders. Unless the Shia-dominated government resolves the problem sensitively and fast, it could push Iraq back towards sectarian mayhem and prevent the emergence of a stable political system.

Two years ago the Americans helped Sunni tribal leaders, especially in Anbar province to the west of Baghdad but also in other more mixed provinces, to create Awakening Councils which set up paramilitary forces known as the Sons of Iraq. Tens of thousands of mainly Sunni militants joined these outfits, turning against al-Qaeda and other extreme Sunni groups in return for a monthly salary. Their gunmen now man checkpoints in districts that used to be highly dangerous for American or Iraqi regular forces, such as Fadhil in northern Baghdad or Ghazaliya in the west. Diyala, a mixed Sunni-Shia province north-east of Baghdad, is also prime territory for the guards, whom the Americans see as a key to reversing the sectarian conflict that raged from 2005 until 18 months ago.

But Iraq's government is wary of the *Sahwa*, as the Awakening is known in Arabic, and suspects that many of the Sons of Iraq carried out killings in the past against families just because they were Shia. Such suspicions are reciprocated by Sunnis towards Shia militiamen, many of whom have been enrolled in the army and police.

Reuters

Let more Sons join the army too

The Iraqi authorities were supposed to start paying the Sons of Iraq at the end of last year; from this month, the Americans will no longer subsidise such payments. About a fifth of the Sons, who number around 100,000, were to be folded into the regular police or army, while the rest were to be helped into jobs in the public sector.

But it is happening too slowly, if at all. Many Sunnis were especially enraged by a recent government decision to issue arrest warrants for several hundred *Sahwa* people accused of terrorist acts in the past. This flouts the spirit of conciliation. Many young Sunnis say a witch-hunt has begun.

Some Sunni guards have not been paid for three months, stirring resentment and a sense of discrimination. Parliament has not helped by refusing to pass a budget to earmark millions of dollars for the Awakening Councils. In addition, a shortage of cash at the interior ministry means there is less money to hire recruits, thereby stalling the absorption of former fighters into the police. As the Americans begin to withdraw, one-time Sunni insurgents are starting to wonder if they will be left high and dry. Some are asking if they were right to turn away from al-Qaeda in the first place.

So far Anbar, once the heart of the Sunni insurgency, has proved an exception to the rule. There the Sons of Iraq have been embraced by the local authorities as heroes for stemming the violence. A number of ex-fighters even ran for office in provincial elections in January, winning seats on the council alongside the established parties. But in other mainly Sunni provinces the mood is febrile. The government needs to accommodate the former insurgents before they go back to their old ways.

The Khodorkovsky case

A new Moscow show trial

Apr 2nd 2009 | MOSCOW
From The Economist print edition

A fresh trial of Russia's jailed oligarch is a critical test for President Medvedev

AP

BIG changes in Russian political life are often ushered in by trials. The first show trial of the Shakhty engineers in 1928 paved the way for Stalin's consolidation of power in 1929. The 1935-36 trials of Kamenev and Zinoviev, two Bolshevik revolutionaries who fell out with Stalin, heralded the great terror a year later. The trial of Mikhail Khodorkovsky and Platon Lebedev, which opened in Moscow on March 31st, could be as pivotal for Russian political life today.

This is the second trial of Mr Khodorkovsky—and the first under the presidency of Dmitry Medvedev. It may earn Mr Medvedev either a place in history or a footnote in the story of his predecessor, Vladimir Putin. The arrest of Mr Lebedev in July 2003, followed by that of Mr Khodorkovsky in October 2003, ended in the destruction of their Yukos oil company and eight-year jail terms for both men. It heralded a turn away from the liberalism of the 1990s towards an authoritarian corporatism. And it began the redistribution of property and power towards former and present security-service men, collectively known as *siloviki*.

Mr Khodorkovsky has asserted in interviews that it was the *siloviki*'s informal leader, Igor Sechin, now deputy prime minister, who initiated the attack on Yukos. He says that the *siloviki* favour isolation over integration, secrecy over transparency and repression over the rule of law. The Yukos dismemberment was their victory. It ended a brief period of politically independent courts, turning them into a mechanism of repression. As Lyudmila Alekseeva, a noted human-rights advocate and dissident, puts it, Mr Khodorkovsky was not a prisoner of conscience and was not tried for his beliefs—but he is a victim of political repression.

His firmness and dignity in jail have indeed brought Mr Khodorkovsky closer to generations of political prisoners in Russia, a point he underlined at the opening of his trial this week by adopting a slogan of 1970s dissidents: "Power: carry out your laws". This ought to resonate with Mr Medvedev, who likes to advertise his background as a lawyer and his priorities of making the courts independent and fighting what he has labelled "legal nihilism".

The defence lawyers argue that the case against Mr Khodorkovsky and Mr Lebedev is a prime example of

legal nihilism. It ignores the universal rule that nobody can be tried for the same crime twice. And it goes over the same territory and time. In the first trial, Mr Khodorkovsky and his partners were accused of tax evasion. Now they are charged with the embezzlement of 350m tonnes of oil and laundering the proceeds through offshore trading companies. This is the same oil on which Mr Khodorkovsky was said not to have paid enough tax, says Vadim Klyuvgant, Mr Khodorkovsky's lawyer.

Mr Klyuvgant says that none of the 188 volumes of prosecution evidence in the case explains how Mr Khodorkovsky stole Yukos's entire oil production over six years. Instead they imply that the existence of what was once the country's largest and most transparent firm was illegal. In that case, Mr Khodorkovsky retorted in court, anyone (including the prosecutors) who bought petrol from a Yukos filling station in those years participated in the crime.

The maximum sentence for the charges is 22 years. Yuri Shmidt, a lawyer whose father was jailed both in 1929 and in 1937, says that "they could not bring these charges against Khodorkovsky in 2004. The Kremlin was still mindful of public opinion at home and abroad. Today it feels it can do whatever it likes." And yet the outcome of the second trial is uncertain.

For one thing, the public mood is different. In 2003 Mr Khodorkovsky's arrest was seen as the first sign of the state's reckoning with the unpopular oligarchs, who had not deserved their sudden riches. His imprisonment seemed to many to be just, if not strictly legal. Today, he is a prisoner who has lost everything and did not break down in a tough Siberian prison camp. He commands far more sympathy and respect than bureaucrats and politicians.

The case was initiated in 2006 but has lain dormant for the past year. It has come to the fore now for two reasons. Mr Khodorkovsky's sentence runs out in 2011, a few months before the next presidential election, which could put Mr Putin back in the Kremlin. A free (and popular) Mr Khodorkovsky could yet interfere with this plan by running himself, or backing another candidate.

Even more alarming for the Kremlin is that Yukos's former management has brought a case to the European Court of Human Rights in Strasbourg. If the court finds that Russia applied the law retrospectively and unlawfully levied $34 billion in back taxes that destroyed the company, or that it singled out Yukos to disguise expropriation, it could order the government to compensate the company and its shareholders. This embarrassing prospect is so serious that some claim it prompted the Kremlin to discuss whether to pull out of the Council of Europe.

The coincidence in the timing of the Strasbourg case and the Moscow trial is striking. On January 29th the European court declared that the Yukos case was admissible. Within days, the Russian prosecutors had issued a criminal indictment against Mr Khodorkovsky, having concluded their investigation two years earlier. The Kremlin may be hoping that a Russian court ruling that declared Yukos's operations to be illegal could enable it to stall the Strasbourg case.

But as Kirill Rogov, a political analyst, argues, those who started this case cannot win it politically. To convict Mr Khodorkovsky this time round would raise doubts over his guilt in the first case: the charges look contradictory. But nor can they just let Mr Khodorkovsky go. Pragmatists in the Kremlin may prefer to negotiate with Mr Khodorkovsky, offering him an acquittal or short sentence in exchange for dropping Yukos's claims to compensation and showing his gratitude.

As a lawyer, Mr Medvedev has little interest in being tainted by another sham trial in Moscow. He has been careful to distance himself from the Yukos affair. Mr Khodorkovsky acknowledges this. In one interview through his lawyers he said: "I respect Dmitry Medvedev as Russia's legitimate president, although his political views are not completely clear to me. He certainly did not plunder Yukos and has nothing to fear from Platon Lebedev or myself." At the opening of the trial, Mr Khodorkovsky cited Mr Medvedev's words about law and corruption. But he did not pull any punches when talking about the prosecutors who put him in jail.

Letting Mr Khodorkovsky out must have attractions for Mr Medvedev. It would strengthen him as a force in Russian politics, gain him international kudos and lay the Yukos ghost that still haunts the Kremlin. But to achieve all this he has to convince Mr Putin and fight those who benefited from the dismantling of Yukos and want Mr Khodorkovsky in prison for the rest of their lives.

Turkish politics

A wake-up call from the voters

Apr 2nd 2009 | ISTANBUL
From The Economist print edition

Turkey's ruling party did unexpectedly badly in local elections

AFP

Flags down for Erdogan

DEFEAT is an unfamiliar concept for Turkey's prime minister, Recep Tayyip Erdogan. Yet his Justice and Development (AK) Party felt it for the first time in local elections on March 29th, when voters gave it only 39% of the vote. That was more than any rival but still a sharp drop from the 47% AK took in the 2007 general election. Mr Erdogan, who treated the local elections as a referendum on himself, was visibly shaken as he declared his unhappiness with the result. AK lost 12 cities, among them Siirt in the south-east, the home town of Mr Erdogan's wife, Emine. It lost the mainly Kurdish city of Van to the Democratic Society Party (DTP), whose strident Kurdish nationalist message trumped Mr Erdogan's talk of the common bond of Islam.

The elections were a triumph for Turkey's shaky democracy. In 2007 the fiercely secular generals led a crude campaign to unseat the government. They threatened a coup when Mr Erdogan nominated Abdullah Gul, his foreign minister, as president, because his wife's Islamic-style headscarf threatened Ataturk's secular principles. Their campaign backfired: AK swept back for a second term and Mr Gul became president. The generals then egged on the chief prosecutor to bring a case before the Constitutional Court to ban AK on charges of seeking to impose *sharia* law. The party narrowly escaped closure when the court delivered its verdict last July.

Chastened, the army kept quiet in the latest elections. The secular opposition Republican People's Party (CHP) made modest gains, taking 23% of the vote. It put up a tough if losing battle against AK in Ankara and Istanbul. In the largely Kurdish south-east the DTP took a thumping 75% in the provincial capital, Diyarbakir. Elsewhere, the far-right Nationalist Action Party (MHP) and the overtly Islamist Felicity Party did well. The message from the voters, one Western diplomat suggested, was that "they want a check on AK hegemony."

As Mr Erdogan's people lick their wounds, two lessons stand out. One concerns the economy. Mr Erdogan's claims that the global meltdown had not affected Turkey angered voters, who face rising unemployment (13.6% in December), shrinking GDP and a tumbling lira. The second stems from Mr Erdogan's waning appetite for the reforms that led the European Union to open membership talks with Turkey in 2005. Liberals, hitherto among AK's staunchest defenders, are defecting.

Attempts by more radical AK types to emphasise the role of Islam in public life spooked others. The AK incumbent lost in Antalya, even though Mr Erdogan is said to have visited the resort 26 times. Mr Erdogan's authoritarian bent and his quarrels with the secular press did not help. On the other side, Mr Erdogan's failure to deliver on issues dear to his pious constituents, such as easing the ban on the headscarf, allowed Felicity to snatch some voters away. AK no longer unites the different strands of Turks, be they sectarian, ethnic or ideological, as it once did. The conundrum for Mr Erdogan is how to please one constituency without antagonising another.

One way forward might be to re-embrace the reformist zeal that first propelled AK to power in 2002. In the south-east, AK's efforts to strike a deal with Iraqi Kurdish leaders to disarm rebels from the Kurdistan Workers' Party (PKK) holed up on the Iran-Iraq border are encouraging. But they will not succeed if AK keeps snubbing the biggest Kurdish party, the DTP.

The MHP's success will make both dealing with the PKK and rewriting the Turkish constitution, drawn up by the generals after their coup in 1980, trickier. Meeting the EU's year-end deadline to open Turkey's

ports to Greek-Cypriot ships and planes will also be a challenge. And Mr Erdogan must be ready to strike a fresh standby arrangement with the IMF to reassure jittery foreign investors.

Such an agenda suggests that Mr Erdogan should reach out to the mainstream opposition CHP, which he has been reluctant to do in the past. Yet if he wants to remain Turkey's most popular politician, he may have to set aside his pride.

Bosnia's future

A tearing sound

Apr 2nd 2009 | BANJA LUKA AND SARAJEVO
From The Economist print edition

Could fighting resume?

A JOKE doing the rounds has it that nothing can succeed in Bosnia, not even a crisis. Pessimists note that Yugoslavs used to tell a similar joke in the 1980s. One diplomat believes that Bosnia's gridlock has got so bad, and the political atmosphere so poisonous, that for the first time since 1995 the unthinkable of renewed fighting is thinkable once again. This does not mean a new war is imminent. But conflict is now a distinct possibility.

On March 27th Miroslav Lajcak, the new Slovak foreign minister, held a party for Valentin Inzko, his Austrian successor as the international high representative in Bosnia. He is the fourth man who is due to be the last in his job. Yet at least until the end of the year, his powerful office will stay open. After that Mr Inzko is meant to remain only in his capacity as the European Union's special representative, with no legal powers.

Much of the panic over Bosnia revolves around whether this switch from a powerful high representative to a weaker EU envoy is sensible. And not just that. After the end of the war in 1995 Bosnia was flooded with 60,000 NATO-led peacekeepers. Today there are 2,000 bored, EU-led ones. By the end of the year that number may have shrunk to 200. The pessimistic diplomat suggests that this is all horrible, an appalling mistake that risks sending the wrong signals at the wrong time.

At Mr Lajcak's party Serbs, Croats and Bosniaks (Bosnian Muslims) greeted each other but then clustered in their own groups. Writ large, that is Bosnia's problem. Its complex constitutional structure works well enough for day-to-day matters, but has ground to a halt on any issues of real significance. At least on March 26th an historic deal struck over the future of Brcko, an autonomous town within Bosnia, was endorsed by all sides.

Bosniak leaders, such as Haris Silajdzic, one of the country's three presidents, want the Serb entity in Bosnia, the Republika Srpska, to be abolished, saying it was created through genocide. His nemesis, Milorad Dodik, Republika Srpska's prime minister, responds with the threat of a referendum on secession. They need and feed each other, comments Milos Solaja, who heads the Centre for International Relations in Banja Luka.

In cafés and think-tanks there are suggestions that all sides are arming again, albeit discreetly through hunting clubs and security firms. There is no hard evidence of this. Indeed, Igor Radojicic, speaker of the Republika Srpska's parliament, says that these "ridiculous" stories are spread deliberately by Bosniaks, who want to make sure that the high representative's office does not close and to lure the new Obama administration to their side.

Most Bosnian Serbs say secession is not realistic. They just want to defend the autonomy they won in the 1995 Dayton accords that ended the war. Bosniaks believe that, by blocking as much legislation as he can, Mr Dodik is following the example of Milo Djukanovic, the Montenegrin leader, when he set out to prove that the loose federation of Serbia and Montenegro could not work. Meanwhile, the Croat-Bosniak federation is teetering close to bankruptcy, with vast sums going to so-called war veterans, who constitute a powerful lobby.

Little will now be done in Bosnia until the party congress of the leading Bosniak party in May. Sulejman Tihic, who has initiated serious talks with his Serb and Croat counterparts about the country's future, faces a challenge to his leadership. He is charged with treachery by his Bosniak enemies. As the economic crisis worsens, Bosnian leaders will do what they do best, which is to play on fear. For now all agree that

there is no appetite for war among ordinary Bosnians. But fear and anger could, if shaken up enough, turn into a deadly cocktail for their country.

Troubled Macedonia

The name game

Apr 2nd 2009 | SKOPJE
From The Economist print edition

Annoy Greece, put up more statues of Alexander

THE winner of the second round of Macedonia's presidential election on April 5th will almost certainly be Georgi Ivanov, the candidate of the ruling nationalist party led by the prime minister, Nikola Gruevski. But that does not mean he will get the job. He is unpopular with ethnic Albanians, who make up a quarter of Macedonia's 2.1m people. If most of them do not vote, turnout could fall below 40%—in which case the entire election has to be rerun.

That would be a problem Macedonia does not need. Its economy is stuttering. Exports of metals, textiles and farm produce have slumped. Unemployment is high, public spending must be cut and tensions are rising. Violence broke out in Skopje on March 28th during a protest over plans for a new church in the centre.

Macedonia remains fragile eight years after it almost lapsed into war. Testy relations with its neighbours do not help. For 18 years it has been locked in conflict with Greece over its name, which the Greeks say implies territorial pretensions to Greek Macedonia. Macedonia has won sympathy from other European countries in this dispute. But under the nationalist Mr Gruevski, it is losing it.

When Macedonia renamed Skopje airport for Alexander the Great in 2007, this seemed a one-off to annoy Greece. More recently, however, the government has broadened a policy the opposition calls "antiquisation". The main road to Greece has been renamed for Alexander and the national sports stadium named after his father, and plans are afoot to erect a huge statue of Alexander in central Skopje. These gestures play well to a public that was incensed by Greece's veto of an invitation to Macedonia to join NATO, but the country is losing friends. "It is nuts," sighs one diplomat. "They don't see the cause and effect."

Alexander died in 323BC. The Slavs arrived only a thousand years later. But, says Pasko Kuzman, an archaeologist at the culture ministry, Macedonians are a mix of all the people who have ever lived in the region, so they have every right to treat Alexander as a symbol. Besides, he adds, Greece denies the very existence of a Macedonian minority in Greece.

Macedonia's ethnic Albanians have mostly stayed out of this debate. Some officials say antiquisation was a sop to offset the shock of not being let into NATO. They dearly want the European Union to grant visa-free travel to Macedonians this year (and then open membership talks). If people in Macedonia and elsewhere in the western Balkans lose hope of ever joining the EU, says Macedonia's deputy prime minister, Ivica Bocevski, everybody should start worrying about regional stability.

Economist.com
WORLD
EUROPE

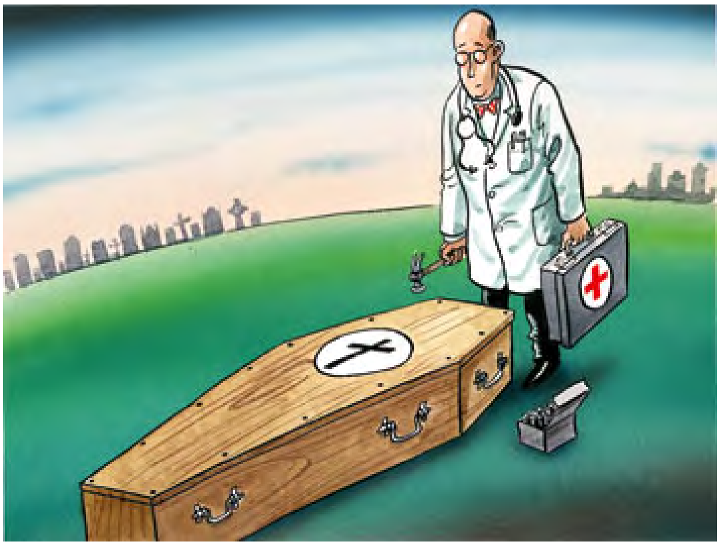
Charlemagne

The great euthanasia debate

Apr 2nd 2009
From The Economist print edition

How attitudes to mercy killings differ around Europe

Illustration by Peter Schrank



TWO European countries, Britain and Belgium, have had cause in recent weeks to ponder the same ethical question: what happens when doctors decide a patient has no chance of a bearable life? In Britain headlines reported the grief of parents whose wishes were overruled by the courts, allowing doctors to turn off the ventilators keeping their son alive. Shortly afterwards a new study reported that active euthanasia—in which not only is medical care withdrawn, but drugs are used to shorten life—is opposed by two-thirds of British doctors.

A similar debate has broken out in Belgium, another European country that has moved in a broadly secular, permissive direction over the past few decades. But this one was very different. Buried on inside pages, small newspaper stories reported a survey of paediatric intensive-care nurses. It emerged that they had witnessed two dozen infants and children being given lethal drugs to speed their deaths. That amounts to involuntary euthanasia, which is illegal (though Belgium, like the Netherlands, has legalised euthanasia for consenting adults). Asked if the law should be changed to allow the ending of minors' lives, 89% of nurses in the Belgian study said yes.

This was not a rogue result. In 2005 academics investigated all 292 children who died before their first birthday in a given year in Flanders, the Dutch-speaking bit of Belgium. In half the cases, doctors had taken an "end-of-life decision", a term that takes in three distinct practices. Most often, doctors withdrew or withheld treatment keeping infants alive, which is quite a common practice. In 40 cases, painkillers such as morphine were used to alleviate suffering, but at high doses likely to hasten death: a legal grey area. In 17 cases lethal drugs or doses were illegally given to end life. Similar practices were revealed by a study in the Netherlands; that led to the appointment of a committee to review cases where a baby's suffering seems impossible to relieve, suggesting that a swift death might be merciful.

Even to set up such a committee would be controversial in most of Europe, especially where church leaders retain political clout. In Britain debate on euthanasia revolves around gravely ill adults who consciously want to die. Even in such secular, permissive countries as Sweden, doctors tell surveys they oppose euthanasia by large margins. What explains these differences?

Religious faith is important, but can be trumped. A 2006 study found that in Italy and Poland, practising Catholics were more hostile to euthanasia than their less devout compatriots. But in France, the Netherlands, Belgium and Scandinavia, believers and their secular neighbours hold similar views.

Memories of Nazi programmes to murder unwanted citizens under the label of “euthanasia” make Germans cautious, regardless of religion. The author of the recent British studies, Clive Seale of London University, notes another wrinkle: British doctors are more religious than the population at large, with half calling themselves somewhat, very or extremely religious, as opposed to a third of ordinary Britons. (Not all those devout doctors are Christians: the National Health Service employs many Asians and British Asians).

National character matters too. In the Netherlands, euthanasia is mostly carried out by family doctors, who know their patients well. The Dutch are an outspoken, demanding bunch, who expect straight answers, says Luc Deliens, a Belgian academic. Things are different in southern Europe, where doctor-patient relationships are more hierarchical. The Dutch, a seafaring nation of traders, have also long imported new and foreign opinions. They are used to resolving conflicting principles, says Dick Willems, a Dutch doctor and ethicist. There has never been “one very strong common idea about what is allowed”.

Economics plays a role, he adds. In America a long terminal illness can leave people deep in debt: that makes ethicists fear that euthanasia might be requested for financial reasons. In Dutch hospitals, compulsory insurance covers even the most expensive treatments, lessening such fears.

When to pull the plug

Arguably, some countries are in denial. In only a few countries have there been serious attempts to measure the incidence of euthanasia. Academics found it existed in every country studied. London University studies estimate that one in 500 deaths in Britain involve voluntary euthanasia, and one in 300 involuntary euthanasia. That amounts to 3,000 deaths a year, outside any legal framework. British numbers are “disturbing” and cry out for regulation, says Mr Deliens. Britain also has a higher than average incidence of “terminal sedation”, where patients are kept unconscious until they die. Critics call this “slow euthanasia”.

Some worry that legal euthanasia creates a slippery slope towards state-sponsored killing. Legalisation has not made euthanasia more common, Dutch experts insist: the main effect is to improve communication between doctors, patients and families. Yet not all legal grey areas can be resolved. Take the recent cases in Belgium, mostly of newborns whose lives were ended with lethal drugs. A typical case might involve an irreversibly brain-damaged newborn taken off artificial respiration who, instead of dying as expected, lingers on, suffering terribly. In such cases, some doctors feel obliged to hasten death. A law formalising rules for such cases would be a mistake, suggests Mr Willems. Some decisions should remain morally and personally difficult.

The honesty of the Belgian and Dutch debate can feel pretty brutal. But whatever one’s views of euthanasia, openness is surely to be applauded. The phenomenon is only now being studied properly. And when Europeans know, they will need to decide what they really think.

Charlemagne now writes a blog, which is open for comment at
Economist.com/blogs/charlemagne

Renewable energy

Greenstanding

Apr 2nd 2009
From The Economist print edition

Gordon Brown's New Deal will do little to advance renewable energy

Alamy

ONE of the most impressive monuments to Franklin D. Roosevelt's New Deal is the network of dams that stud the Tennessee River valley, built to provide work and to modernise a backward corner of America during the Great Depression. Seventy-five years later and on the other side of the Atlantic, work is once again growing scarce and an economy is in need of modernisation, this time to secure energy supplies and slash the release of planet-heating greenhouse gases. The British government has been playing up the parallels, with much ministerial talk of a "Green New Deal". In March Gordon Brown promised the creation of a "low-carbon economy" for Britain that would provide jobs and clean up industry. Lord Mandelson, his business secretary, talked of a new industrial revolution and said that there was "no high-carbon future".

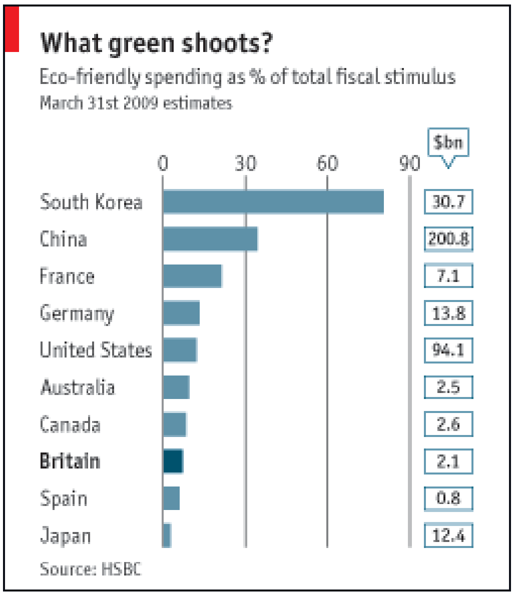
It is a seductive vision. If Keynesian stimulus is to be the order of the day, greenery seems a good sector in which to apply it. There are benefits besides decarbonisation. Much of the contribution would come from changing the way electricity is generated, and many of Britain's old power plants need replacing anyway. A switch to renewable power would cut dependence on oil and natural gas as national production of both dwindles. Windy, storm-lashed Britain is a good place to harness the weather; boosters talk excitedly of a splurge on renewable electricity and the possibility of capturing the market for offshore wind turbines or wave-power machines, creating tens of thousands of jobs. On April 1st Statkraft, a state-owned Norwegian firm, said it was investing £500m ($715m) in a Scottish wind-farm project.

Not everyone is convinced. Green rhetoric in Britain has traditionally soared far above reality. Greenhouse-gas emissions are more or less unchanged since Labour came to power in 1997 (a better record than many countries, but hardly the promised transformation). Less than 5% of British electricity came from renewable sources in 2006, compared with 26% in Denmark and 48% in Sweden. Ambitious goals to derive 30-35% of electricity from renewable sources by 2020 are widely considered impossible. A related pledge that 15% of total energy consumption (of which electricity accounts for roughly a third) will be renewable by that date looks even less plausible.

Mr Brown's green New Deal looks similarly flimsy. On March 31st HSBC, a big bank, published a report ranking countries by how green their economic-stimulus packages were. The bank reckons that Britain is allocating just 7% of its fiscal stimulus to greenery, compared with 12% in America, 34% in China and a whopping 81% in South Korea (see chart). A separate report prepared for Greenpeace, a pressure group,

by consultants at the New Economics Foundation (NEF) considers only genuinely new funding and arrives at a figure of just 0.6%, or £120m.

Private-sector caution reflects this official inaction. Lower oil prices, sagging demand for energy and hard-to-get credit have caused many firms to cut back on renewables worldwide. But there are particular problems in Britain, not least the falling pound (most of the wind turbines installed there, for example, are built in continental Europe).



Energy companies such as Centrica and EDF, a French firm, are re-evaluating their British renewables projects. Lord Browne, a former boss of the big British oil firm BP, doubts that Britain's laissez-faire energy policy is up to the job of decarbonising the economy, and wants state-owned banks directed to finance green-energy projects. (BP has opted out of the British renewables market because it expects low returns.) And last year Royal Dutch Shell pulled out of a £3 billion wind-farm in the Thames estuary.

Convinced that these are short-term problems, fans of renewables want government cash to see projects through the tough times. But there are longer-term reasons for Britain's comparative sluggishness. Its subsidy regime, under which green power stations generate tradable certificates, is unwieldy compared with traditional cash handouts in other countries. In the past, all technologies were subsidised equally, so most investment went into onshore wind, the cheapest source of renewable energy. But windy spots tend to be beautiful spots, and local opposition bogged down projects. There have been reforms: planning changes have made local objections easier to ignore, and the subsidy scheme was tweaked on April 1st to give extra cash to more expensive technologies, such as offshore wind turbines. An independent Climate Change Committee is supposed to advise on and police legally binding emissions-reduction targets, but it is new and its powers untested.

One fear shared by many enthusiasts of renewables, says Andrew Simms, policy director of the NEF, is that the government is simply losing interest in them. It has moved speedily to revive the nuclear-power industry, by contrast. From a position of cordial dislike in 2003, the government announced itself in favour of new nuclear plants in principle as early as 2006.

More recently ministers have been positively prescriptive, suggesting how many plants might be built and where. A takeover of British Energy, which runs most existing nuclear plants, by EDF, keen to build more, took place last year. A new nuclear laboratory has been founded, schemes to train workers set up and the vexed issue of waste disposal re-examined.

Nuclear-power stations take many years to build, so new ones will not help Britain meet its 2020 targets for curbing emissions. But the technology is well understood. Politicians may have calculated that a few nuclear-power stations will be easier to sell the public than thousands of wind turbines. And energy does not have to be renewable to be low-carbon.

Jacqui Smith

There's a recession on, you know

Apr 2nd 2009
From The Economist print edition

MPs continue to feather their nests, even as voters feel the pinch

THE steady drip-drip of sleaze stories in recent years was not enough to make MPs clean up their lax expenses regime. The current deluge is forcing them to. On March 29th it was revealed that Jacqui Smith, the home secretary, already under parliamentary investigation for claiming the so-called second-home allowance on a property some suspect is her main residence, had also asked taxpayers to pay for her television package. Her receipts included pay-per-view films watched by her husband, two of which were pornographic. She has apologised and has returned the money.

Outrage at politicians playing fast and loose with public funds had already been stoked by revelations about Tony McNulty, a welfare minister embroiled in a second-home controversy of his own. The twin scandals, along with official figures showing that MPs' total expenses had risen by 6% to £93m in 2007-08, prompted Gordon Brown to ask the independent Committee on Standards in Public Life to bring forward its inquiry into MPs' finances. Its still-leisurely report is now expected towards the end of this year. The prime minister himself favours replacing the vexed allowance (worth up to £24,000 a year) with a flat-rate payment for overnight stays.

The Smith story may be unusually eye-catching (some say the real scandal is less the blue movies than her husband's enthusiasm for "Ocean's 13", which he mystifyingly ordered twice), but the prevalence of such feather-bedding is striking. Fear that they too have scandals waiting to be exposed explains the Conservatives' muted criticism of Ms Smith, not any generosity of spirit. Even Eric Pickles, the party chairman who notionally provides a common touch, seemed tin-eared during a television debate on March 26th as he tried to justify his need for a second home even though he lives only 37 miles from London.

Both parties also sense that popular disquiet doesn't stop at parliamentary expenses and allowances; a public sector grown rich after a decade of pay rises is provocative to private-sector workers who increasingly face redundancies and frozen salaries. George Osborne, the shadow chancellor, wants to curb the remuneration of public-sector "fat cats" such as quango bosses. The government is casting a beady eye over severance terms and early retirement in the civil service. Local authorities are to be forced to reveal more about pay and perks.

Certainly, the prospects for reform seem sunnier than Ms Smith's future. Mr Brown has backed her in equivocal terms, and rumours that she will be sacked in a summer reshuffle pre-date her latest crisis. If she is moved, Mr Brown's choice of a successor to run the home office (still a big job, but also a graveyard for promising political careers) will be pored over for clues to a future Labour-leadership contest.

Politics and the internet

Today, Strasbourg; next, the world

Apr 2nd 2009
From The Economist print edition

The lessons of the latest viral sensation

IF GORDON BROWN was embarrassed by his recent rhetorical skewering at the hands of Daniel Hannan, a Conservative member of the European Parliament (MEP), Britain's established media can sympathise. Journalists were tipped off about the speech before its delivery on March 24th but chose not to cover it. Broadcasters did not deem it worth showing for several days. Yet indifference from those accustomed to managing the flow of information from politicians to voters failed to stop the speech, delivered after the prime minister's own address to the Strasbourg parliament, from attracting more than a million internet viewings within a week.

For the British left, it was painful confirmation of its tardiness in mastering new media. The most popular political blogs are Tory-leaning, and the Conservatives' overhauled website is more impressive than the Labour Party's lacklustre effort. Some suggest that right-wing views are inherently more suited to delivery in punchy form; the most successful tabloid newspapers are, after all, conservative. But that fails to explain the American left's internet successes, including MoveOn, an online advocacy group set up during Bill Clinton's presidency, and Barack Obama's election campaigns against Hillary Clinton and John McCain. Others blame a lack of internet savvy in a New Labour apparatus that was built in the 1990s to deal with the traditional media. That may account for the state of the party's official website, but not for the left's deficit in the blogosphere.

The most plausible explanation, confess some Tories, may be that the internet is a largely oppositional medium. Incumbent parties can count on media coverage; oppositions must be resourceful to get noticed. There may also be less tolerance of dissent in a governing party, making for duller debate online. Commentators on LabourList, the left's answer to ConservativeHome, a popular website among Tories, have been criticised for straying too rarely from the Labour line for fear of being blacklisted by the party. Some activists say Labour must undergo its own *glasnost* to become truly vibrant online. That may come if it loses power at the next election. A subsequent leadership contest would also help; ConservativeHome really took off during the Tories' prolonged and vituperative leadership race of 2005.

Still, Mr Hannan's triumph was a mixed blessing for the Conservatives themselves. Despite his mere 37 years, Mr Hannan is a more old-fashioned conservative than those who lead his party. Not only was his speech dominated by support for laissez-faire economics and hostility to the EU—two positions the Tories have spent recent years striving to moderate and play down respectively—but it was also delivered in the pugnacious style that failed to impress voters when William Hague, the shadow foreign secretary, tried it in his previous life as Tory leader. The popularity of the video, to which there was not even a link on the party's official website, was an ill omen for senior Tories. They will have a much tougher time controlling the party's messages to voters in the run-up to the next election than Labour did before 1997.

Recent months have seen the online pioneers of the Obama campaign visit Britain to dispense their wisdom to fawning neophytes of both parties. But it is the internet's potential as a governing tool that grips many in Westminster. The Tories, and many within Labour, aspire to a "post-bureaucratic" way of running public services, with information about things such as hospital performance and crime patterns widely dispersed, personal budgets for health and social care managed online like bank accounts and innovative policies open-sourced rather than solicited only from civil servants. Much of this sounds fanciful, but so does a humble MEP's rise to stardom on the back of a three-minute speech to a half-empty chamber.

British tax havens

Sinking assets

Apr 2nd 2009
From The Economist print edition

Global reforms pose a threat to those nice little earners

Illustration by David Simonds

IN BENIGN times Britain could smile remotely on its far-flung territories, sending the odd royal to fly the Union Flag. But corruption in the Turks and Caicos Islands, which might soon require direct rule again from London, are a harbinger of what may happen closer to home as the crackdown on offshore tax havens gets tougher, gaining momentum from the G20 summit this week. Jersey and Guernsey, two islands less than 100 miles from Britain, owe 50% and 40% respectively of their income to financial services. How much of that would survive if those businesses were forced to be totally transparent is open to question.

One of Jersey's biggest earners until recently was the securitisation of financial assets; that market is all but dead. One of Guernsey's claims to fame is a trust law that allows the sponsor of a trust to reclaim its assets at will—making a nonsense of the trust concept. Richard Murphy, who campaigns against tax havens, argues that, whatever else they may claim, these two Channel Islands rely on secrecy to attract business. If that is stripped away they are "dead in the water", he says.

A spokesman for Guernsey insists that the island meets three good-housekeeping criteria: on transparency, effective regulation and co-operation with other tax authorities. Recent pressure has encouraged Jersey and Guernsey to sign bilateral information-exchange agreements with a dozen countries. Yet the two islands are still refusing to swap information automatically under the European Union's savings-tax directive, though they collect some tax on behalf of other countries under an option that keeps the beneficiaries' identity secret. Pressure for more disclosure is mounting, but so is competition among tax havens. Jersey and Guernsey recently had to match the Isle of Man (another British dependency, this one in the Irish Sea) by reducing their tax rates on non-financial firms to zero. The Isle of Man stands to lose less from corporate freeloading: it has fewer local companies than Jersey and receives a subsidy of around £200m ($286 million) a year from pooling value-added tax returns with Britain, Mr Murphy says.

Pressure to reveal all is coming from another direction too. The bail-out of much of Britain's financial sector has prompted a crackdown on the tax-avoidance tricks used by banks, especially those which have the taxpayer as shareholder. The Treasury plans to introduce a "voluntary" code that would require banks to obey the spirit as well as the letter of tax law. Who exactly will determine when the spirit has been infringed is a matter for speculation.

Britain's offshore dependencies were facing a tougher future even before this bout of reforming zeal. In November 2007 the National Audit Office pointed to the "contingent liabilities" that would face the government if any of these territories saw a financial collapse or regulatory failure: at best it would damage Britain's reputation and at worst it would prompt a call for direct aid. A year later the Treasury commissioned a report on British offshore financial centres. Since then the official tone has changed: a simple review of the status quo risks becoming a witch-hunt that threatens the havens' very livelihood, some fear. Michael Foot, the former central banker leading the review, toured the Caribbean last month "mainly to show these territories that I am not the devil incarnate", he says.

Mr Murphy suggests a reason for Britain's volte-face: now that transparency is being forced on tax havens worldwide, the British government may as well swim with the tide and at least collect some revenue. The days when British offshore havens helped to keep sterling and the City afloat are definitely over.

The islands see things differently. They provide legitimate financial services that are quicker and more flexible than even London and New York, they argue. Britain's Cayman Islands, for example, is home to more than half of the world's offshore hedge funds, according to IFSL Research. Rumour has it that the first choice of domicile for fund managers investing, along with the US Treasury, in American banks' toxic assets is Grand Cayman.

Building societies

Dunlending

Apr 2nd 2009 | DUNFERMLINE
From The Economist print edition

Mutuals are catching the banks' ills

BUILDING societies, a Victorian invention to let modest folk save money to buy a home, once seemed as safe as the proverbial houses. No longer. Since the Dunfermline building society, Scotland's largest and in 2007 the country's 12th biggest, collapsed on March 30th and was rushed into a merger with giant Nationwide, they look as iffy as property prices.

Alex Salmond, the nationalist first minister of Scotland's devolved government, was quick to smell a plot by Treasury ministers to strip his country of its last bit of financial grandeur. Why, he asked, were they giving the Nationwide building society £1.6 billion to ease its takeover of the healthy bits of Dunfermline's business (£2.4 billion in savings and £1 billion in mortgages) while nationalising £884m in ailing commercial-property and subprime loans? Why not hand Dunfermline the £60m-100m the Financial Services Authority (FSA) said would keep it in business?

Mainly because £60m would not, in fact, have saved Dunfermline. But there is a broader issue. Since the onset of the credit crunch, many (not least Alistair Darling, the chancellor) have mused on the attractions of narrow banks, limited in their operations and regulated almost like utilities. Building societies are not a million miles from this model. Yet in the past four months, six of the 59 that existed a year ago have been pushed into rescue mergers.

Frozen wholesale money markets are not the cause. Unlike stricken banks, building societies generally get less than 30% of their funding from this source, and less still since banks started tottering. Attracted by their reputation for safety, savers have increased deposits with building societies by £22.6 billion since August 2007.

Nor is there a consistent pattern to the difficulties. The Cheshire (merged with the Nationwide) and the Barnsley (merged with the Yorkshire) both had money in failed Icelandic banks. The Derbyshire (merged with the Nationwide) unwisely dived into subprime lending. The Scarborough (merged with the Skipton) cited "difficult trading conditions". And the Dunfermline fell victim mainly to a misguided rush into commercial-property lending just as the market was hitting its peak.

What caused this veering towards risk, says a former Dunfermline director, was ferocious competition in mortgage lending from banks and the specialist lenders that sprang up in the 1990s. Building societies, obliged to put 75% of their lending into residential mortgages, found profits (which they need to bolster their capital) shrinking. "What do you do when your core product has become everyone else's loss-leader?" asks the ex-director.

The shift should surely have been spotted by the FSA and societies steered back into safer water, some say. Mr Darling agrees. He has asked the regulator to review its supervision of the Dunfermline. Indeed, the FSA too seems to have realised that it is not up to snuff: since January it has had a team dedicated to building societies.

All this has focused attention on just what is special about building societies, particularly now that banks are being exhorted to increase their mortgage lending. Since building societies are owned by their customers and do not pay dividends to shareholders, they should offer cheaper loans and better savings rates. But a recent survey by Moneyfacts, a financial-comparison outfit, found that the average bank was charging 4.3% on variable-rate mortgages and the average building society 5.0%. Banks also paid more for savings.

The mutuals complain that banks' risk-taking has burdened building societies with unfair costs. They too are being asked to hold more capital. Levies to compensate depositors at the failed Bradford & Bingley bank and the British offshoots of Icelandic banks weigh especially heavily on mutuals: retail deposits (on which the levies are calculated) are a high proportion of their total liabilities.

The FSA is looking at these matters now, but tough trading times lie ahead for the building societies whatever it decides. Moody's, a credit-rating agency, reckoned in January that the outlook for half of the leading 16 mutuals was negative. So much for the back-to-basics model.

Economic outlook

Glimmers of hope, forecasts of gloom

Apr 2nd 2009
From The Economist print edition

Despite some encouraging signs, a robust recovery is a long way off

WHEN the economy was last mired in recession, Norman Lamont notoriously spotted some “green shoots” of recovery. Mindful of the scorn heaped upon the Conservative chancellor of the exchequer for his premature optimism in 1991, Gordon Brown and his top brass have avoided cheer in the current downturn, not least because it is so much worse. Two junior ministers were slapped down earlier this year for uttering the taboo phrase.

Despite Labour’s caution, some recent signs suggest that the economy is not entirely moribund. House prices, which have been falling steeply, unexpectedly bounced by 0.9% in March, according to the Nationwide building society. And the number of new loans for house purchase rose from 32,000 in January to 38,000 in February, on figures from the Bank of England. That was still far below the monthly average of close to 115,000 in the first half of 2007, but it suggests that November, when there were just 27,000, marked the bottom in the home-loans market.

A barometer of consumer confidence, based on people’s perceptions about both the economy and their own finances, sent a similar signal. The latest tap on the glass by GfK NOP, a market-research firm, revealed an astonishing pessimism, with a reading of minus 30 in March. Yet even this represented an improvement on the Stygian depths of minus 39 last July, an all-time low since the index started in 1974, or the minus 37 recorded in January 2009.

A closely watched survey of manufacturing conditions offered another glimmer of hope. The purchasing managers’ index was a higher-than-expected 39.1 in March, the best since last October. Since any level below 50 indicates contraction, this suggested that manufacturing was still doing badly—but less terribly than before.

More generally across the economy, a fall in inventories has been exacerbating the recession as firms meet demand from stocks rather than new production. Once they can no longer do this, the downturn will be less severe. Furthermore, banks plan to lend more freely in the next three months, the central bank said on April 2nd.

Yet if some green shoots are appearing, they are doing so in even frostier ground than had been thought. The latest national accounts show that the economy did rather worse in the final quarter of 2008 than was thought before. GDP was 1.6% lower than in the previous three months, the biggest decline since 1980. Output in both the manufacturing and construction sectors slumped by 4.9%, the steepest fall since 1975 and 1980 respectively.

The evidence suggests that GDP has experienced another sharp contraction in the first quarter of this year. Exports have been tumbling along with the collapse in world trade. Until recently one bright spot had been upbeat official figures for retail sales. But these fell by 1.9% in February, bringing them closer to glummer private-sector estimates. Shoppers continued to shun the high street in March, according to the “FootFall” index compiled by Experian, a consumer-research firm.

Forecasts published this week by the OECD suggest that Britain’s economy will continue to shrink for the rest of the year, pushing GDP down by 3.7% in 2009, easily the biggest decline since the second world war. A recovery of sorts will get under way in spring 2010, but over the calendar year national output will slip a further 0.2%.

One reason for this gloomy prediction is that the OECD expects consumer spending to fall by 2.2% this year and by 0.4% in 2010. That would be consistent with what happened late last year, as greater saving trumped the Bank of England’s big cuts in interest rates. Helped by lower mortgage costs, households’ disposable income rose sharply in the final quarter of 2008. Despite this boost, consumer spending fell by 1% as the saving ratio rose from 1.7% of disposable income in the third quarter to 4.8% in the fourth.

Another reason is that the OECD is even more pessimistic about the prospects for Britain's big trading partners, which will limit the boost from net trade owing to a more competitive pound. It expects the euro area to contract by 4.1% in 2009 and 0.3% in 2010, and American GDP to slide by 4% this year and stagnate in 2010. As the G20 leaders who met in London this week know only too well, no economy is an island in today's intertwined world.

The equality industry

Rumblings in quangoland

Apr 2nd 2009
From The Economist print edition

A spat at the equality watchdog highlights wider divisions on policy

THE earnest folk at the old Disability Rights Commission (DRC) might not be everyone's idea of wild party animals. But this week it was alleged that the National Audit Office, a public-spending watchdog, had queried several items in the accounts of the Equality and Human Rights Commission (EHRC), a mega-quango which absorbed various anti-discrimination outfits, including the DRC, in 2007. The auditors are said to have noted impressive partying expenses incurred by fun-loving folk at the disability group, and to have expressed alarm that a lot of laptops apparently went missing when the former Commission for Racial Equality was wound up. Matters are expected to be resolved in the next few weeks, and the accounts approved.

This stumble rounded off a wobbly couple of weeks for the EHRC, in which three senior staff members resigned. Spokesmen insist that the resignations are sheer coincidence: Patrick Diamond, the head of strategy, was wooed away to an unrefusable job at 10 Downing Street, and Nicola Brewer, the chief executive, is said to have been poached for a plum post elsewhere. Kay Hampton, one of the 17 expert commissioners, apparently stepped down because of other work commitments.

Whether or not the ship-jumpings are linked, no one denies that discontent at the commission is rife. Chaired by Trevor Phillips, a former journalist who previously headed the racial-equality enforcer, the new über-quango has a remit spanning age, disability, gender, race, religion, sexuality and human rights of every description, as well as an annual budget of £70m. An old guard sees the EHRC as a campaigning group that ought to speak out against discrimination and prosecute offenders. Mr Phillips prefers to think of himself as a regulator—more Ofcom than Amnesty International—who stays on friendly terms with government and business in order to shape them.

That approach has upset many old firebrands. Herman Ousely, a veteran anti-racism campaigner now elevated to the House of Lords, has criticised the "light-touch" strategy. Sir Bert Massie, a commissioner who used to head the disability-rights unit, believes the body should be more active in enforcement, and is considering resigning himself. And Mr Phillips has upset others with his plain speaking on racism and the problems of multiculturalism ("Just because the [far-right] BNP pick up a tune doesn't mean it's a bad tune," for instance, at a conference last month).

The EHRC says that it is more effective if it saves up its interventions for the big issues—such as threatening legal action over government plans to permit longer pre-charge detention of suspected terrorists—rather than becoming a "language police" providing angry quotes when celebrities make racist remarks. Better to make businesses adopt policies that prevent inequality from arising, it says, than to fight cases retroactively. A big project now under way seeks to show firms how a mixed workforce makes business sense, rather than being a tedious legal requirement. The commission's three-year strategy, due to be published next month, is expected to endorse the softly-softly approach, though about a quarter of the commissioners are said to be uneasy.

With a long-awaited equality bill expected at the end of April, these splits could affect policy. Within the cabinet the left-leaning Harriet Harman, who is minister for women and equalities as well as deputy Labour leader, is at loggerheads with Lord Mandelson, the business secretary and a back-from-the-dead Blairite, who is anxious not to burden companies with new regulations in a recession. A clause forcing firms bidding for state contracts to display the results of a gender-pay audit has reportedly been dropped after lobbying by Lord Mandelson. But a new battle rages, this one over whether companies should be required to disclose the gender and ethnic breakdown of their staff in their annual reports.

The EHRC says it hopes its centrist position will enable it to broker compromises, but there are those who fear that it is simply fighting for the wrong side. The friendship between Lord Mandelson and Mr Phillips is of long standing (the business secretary was the best man at Mr Phillips's wedding). Lord Mandelson's hand may also be strengthened by Mr Diamond's move to Downing Street: he was a Mandelson aide

before joining the commission.

Bagehot

Who runs Britain?

Apr 2nd 2009
From The Economist print edition

Gordon Brown is simultaneously at the peak of his power and bereft of it

Illustration by Steve O'Brien

IN THE gaudy grandeur of the Locarno room in the Foreign Office, the Stars and Stripes and Union Flags embraced like nestling swans. Standing in front of them with Gordon Brown, Barack Obama laid it on thick. He thanked his host for his "extraordinary energy and leadership and initiative" before the G20 summit, owning the "extraordinary debt of gratitude" owed to the prime minister by the world.

This is Mr Brown's imperial moment. He is, ostensibly, at the peak of his power—and not only because of the diplomatic coup that, regardless of its outcome, the summit represents. In some ways he has accrued more power than any recent prime minister. Yet simultaneously, through the caprices of the political cycle and the turn of world affairs, he is haemorrhaging it. He has theatrically striven to save the world; at the same time, he sometimes seems barely to be running Britain.

Albeit inadvertently, under Mr Brown's stewardship the government has taken on responsibilities that a generation or two of socialists could only dream about. It controls much of the banking sector and has a broad remit to re-regulate finance. The state has a renewed role, in Mr Brown's rhetoric but in popular opinion too, as the shield and cure for the depredations of faltering capitalism: the "helping hand of society" underpinning the invisible hand of the market, as Mr Brown puts it, through subsidies and public-works programmes. All that is on top of the broad power—over local government and the public services—accumulated by his predecessors and inherited by him.

In exercising those powers, Mr Brown faces few internal rivals. Tony Blair was often criticised for his presidential style of government. Mr Brown at first gestured towards a more collegiate approach, but it didn't last. He does his own pre-summit diplomacy. He overshadows the largely anonymous cabinet. Moreover, his still-comfortable majority in the House of Commons and Britain's model of government give him a freedom to act, quickly and unobstructed, that Mr Obama must envy.

But another way to describe his primacy is as loneliness; and one explanation for Mr Brown's isolation is that, visibly and otherwise, power is draining from him. Some ministers seem happy to remain inconspicuous—and thus disassociated from his travails. Some have begun posturing for a post-election party-leadership struggle. Advisers calculate when to jump ship. Ordinary Labour MPs distance themselves in self-serving acts of rebellion, such as over the part-privatisation of the post office.

Some of Mr Brown's power is slowly seeping to the opposition. David Cameron, the Conservatives' leader, is not quite so reverentially regarded as Mr Blair was a year before he took office: by then Mr Blair's speeches were received as advance notices of government policy. But the attention and resources of business people, think-tanks and foreign diplomats are gradually migrating to the Tories. (It is doubtful whether Mr Obama would have made time in his London schedule to meet the Tory leader—as he did after his turn at the Foreign Office, slipping him in between Russia and China—had that leader still been, say, Iain Duncan Smith.) Inertia has taken hold of bits of the civil service, as it awaits the new masters it expects to be installed next year.

Power is also leaking out to the press. This week's tawdry revelations over the expenses claimed by the home secretary are probably not (as some maintain) themselves evidence of the government's senescence: MPs of all stripes have long been creative with their expense claims. But the media's sadistic glee over the scandal is telling: it is on to the smell of governmental blood. Journalists may not hasten Mr Brown's political demise, but they can frustrate and torment what may be his final months as prime minister, refracting all political news through the lens of his likely electoral defeat, hampering his efforts to accomplish anything.

The incredible shrinking prime minister

That is the withering process often suffered by unpopular, moribund governments. In Mr Brown's case, however—and despite the clout acquired through the bank nationalisations—the routine ebb has been aggravated by the financial crisis. His constant refrain about its global proportions is a useful dodge; but it is also partly true. For most of Labour's tenure, the government made the political weather. Now, it can only wave an umbrella.

Even in domestic economic policy, the government's authority has been eroded. In the era of "quantitative easing", the boundary between monetary and fiscal policy has blurred. Co-operation with the Bank of England is vital. Its occasionally outspoken governor, Mervyn King, has become a pivotal player.

And it isn't only the bank. Britain's parliamentary select committees lack the heft and resources of their American counterparts. But the Treasury select committee, in particular, has risen to unwonted prominence. It is the forum that summons forth and interrogates key but elusive figures such as Mr King, government officials and the mythic beasts who used to run the commercial banks. The Treasury itself, Mr Brown's old fief, has quietly counteracted his urge to stretch Britain's deficit yet further.

In deeper ways, power was ebbing from Number 10 long before Mr Brown moved in. It has been deferred upwards to the European Union and the World Trade Organisation; shunted down to the devolved government of Scotland, the London mayoralty and the judges; displaced into the internet, and the currency and commodity markets; dispersed around the world as climate change, migration and terrorism have risen in salience. These long-term trends exacerbate the specific emasculations suffered by Mr Brown. His writ may run in the post office, but he is not really in power.

Bagehot now writes a blog, which is open to comment at Economist.com/blogs/bagehot

The G20 summit

The Obama effect

Apr 2nd 2009
From The Economist print edition

If atmospherics were all that mattered, the American president would be well on the way to curing the world's ills

Getty Images

BARACK OBAMA had difficulty pronouncing the name of his Russian counterpart, Dmitry Medvedev, but people forgave him. In fact, they forgave him for almost everything: his aura seemed to glow ever brighter as he made his first foray into global, crisis-busting diplomacy.

A general willingness to give Mr Obama the benefit of the doubt was palpable even among the exuberant anti-capitalist demonstrators jamming the streets of London's financial district—a minority of whom turned violent and clashed with police as they attacked a branch of the Royal Bank of Scotland. "He's got good morals," conceded a graffiti artist called Monkey, while helping his friend scale a traffic light and drape a banner: it depicted a grim reaper clutching fistfuls of banknotes.

Nico, a French resident of London who sported a cardboard box over his head (to denounce climate-change denial), said in muffled tones that he was "not sure about Obama—but he can't be worse than George Bush." Anyway, he opined, "the problem is the madness of the economic system—growth wrecks the environment."

Even the Russians, so determined to wrong-foot America for the past few years, were gracious after the two presidents met and agreed to seek deeper cuts in their strategic arsenals than those foreseen by an existing treaty, which could slash each side's stockpile to 1,700 warheads by 2012. Negotiators were told to set new goals by July, when Mr Obama will visit Moscow.

Recent strains in American-Russian relations had not been good for either country, said Mr Medvedev, as he and Mr Obama vowed to begin a "constructive dialogue" on everything from curbing terrorism to economics. Konstantin Kosachev, head of the Russian parliament's foreign-affairs committee, claimed that the two presidents had broken a "closed circle" in which each side felt the need to respond forcefully

to a perceived provocation by the other. These upbeat noises from a hitherto grumpy Russian official marked a change of tone.

These days, America's ties with China probably matter more to the world than the remnants of superpower diplomacy. And on that front, too, the chemistry was good. With China's President Hu Jintao, Mr Obama agreed that his treasury secretary, Timothy Geithner, would start a Sino-American "strategic and economic dialogue" beginning in Washington, DC, this summer. The Americans said Mr Hu assured them of his commitment to boosting demand as well as improving economic management.

Visiting Downing Street earlier in the day, Mr Obama was at once emollient, self-critical and articulate, in a way that put an initially bashful Gordon Brown at his ease. "I came here to put forward ideas but I also came here to listen and not to lecture," the president said, setting the tone—one that subtly combined humility with firmness about the responsibilities of others—for his meeting with the leaders of 19 developed and emerging economies.

Getty Images

London hails the chief

The president admitted that the United States "has some accounting to do" over the failures in its regulatory system. He said the world had become used to viewing American consumers as the engine of global growth—with a clear hint that his country could no longer play this role, and that spenders in other countries should now be doing their bit. But he rejected the idea of American decline, saying that was an old theory, which had been repeatedly belied by the existence of "a vibrancy to our economic model, a durability to our political model, and a set of ideals that has sustained us through difficult times."

The Economist went to press before the G20 summit ended. But if any of the participants arrived in London spoiling for a fight, it was the leaders of France and Germany, who were at pains from the beginning to stress their absolute accord with one another and their differences with everybody else. At a splashy joint appearance, President Nicolas Sarkozy and Chancellor Angela Merkel said Europe had done a lot already to provide economic stimulus. What was needed was far tougher regulation, whose targets would include hedge funds, traders' pay, rating agencies and tax havens. Both of them seemed keener on trying to prevent financial crises in future than on dealing with the one that is raging now.

But Mr Obama was anxious not to let the Franco-German duo spoil the party. Instead he stressed the "enormous consensus" that existed on the need to reinvigorate the sagging world economy. Among governments, anyway: Nico the box-wearer might beg to disagree.

Elsewhere on the sidelines, more conventional voices were stressing that there could be limits to Mr Obama's ability to dissolve global problems at a stroke: the warming of the American-Russian atmosphere was not a breakthrough comparable with the one achieved by Mikhail Gorbachev in the last days of the cold war.

Dmitri Trenin, director of the Moscow Carnegie Centre, a think-tank, said Messrs Obama and Medvedev had merely "plucked some low-hanging fruit" by signalling that rows over Georgia were no longer the key to their relationship. It was now conceivable, Mr Trenin said, that Russia and America could talk business over NATO expansion and possible Russian help to America over Iran. But Russia might not really want American-Iranian ties to improve too much—and the mood of anti-Americanism which was fanned under ex-President Vladimir Putin (now prime minister) would not disappear from the Russian scene. There are some tricks that even Obama magic cannot pull off.

Economist.com WORLD INTERNATIONAL

Cyberwarfare

A Chinese ghost in the machine?

Apr 2nd 2009 | TALLINN AND TORONTO
From The Economist print edition

Identifying the perpetrator of cyber-attacks can be impossible

CYBERSPACE is ideal for spies. Digitally disguised and undeterred by borders or passports, they can pick locks anywhere in the world, pilfer secrets without trace and even leave toxic traps for the unwary.

Security chiefs are very worried; NATO's new cyberwarfare think-tank in Estonia gets requests for help from across the world. And for researchers outside the charmed circle of high-security clearance, establishing hard evidence of mischief on the net is even harder.

Still, two reports released on March 29th managed to give an intriguing glimpse of the electronic front line, chronicling a systematic surveillance effort, probably controlled by China-based computers, of the Dalai Lama, the Tibetan government-in-exile, and the Tibetan diaspora.

Labelled GhostNet this operation infiltrated 1,295 computers in 103 countries over 22 months, including the foreign ministries of Iran, Indonesia and the Philippines; German, Indian and Pakistani embassies; and organisations such as the Asian Development Bank and NATO.

One report, by two researchers at the University of Cambridge Computer Laboratory in Britain, blamed the Chinese government and drew a firm denial from the authorities in Beijing. The other report, prepared in Canada, was more nuanced. (Both lots of researchers had previously worked in the same research team.)

That China might be using the internet to spy on Tibetan activists' international contacts is less striking, perhaps, than the remarkable ease with which they snooped on victims. Attackers used what are known as Targeted Trojans, e-mails sent to specific individuals that contain malicious software or "malware" hidden in an attached document or photo, or a link to an internet site to which the recipient is directed. To fool the victim, the sender poses as someone the recipient knows.

To make that disguise plausible, the sender must find out the victims' trusted contacts, their style of writing and preferred topics. The case cited in the investigation involved someone posing as a member of the Free Tibet group who sent a translation of a book—to a Tibetan monk.

When the attachment is opened, the malware burrows deep into the computer where it ferrets around for useful information, sends it back to the controlling computer and asks for further instructions.

Targeted Trojans are increasingly popular with spies and criminals. MessageLabs Intelligence, a British firm that monitors security threats, detected one or two per week in 2005, but is now seeing an average of 50 per day, says Paul Woods, the firm's senior strategist. The software does not require the resources of a state intelligence agency; it can easily be found on the internet. This is one reason why the Canadian researchers (at the University of Toronto and SecDev Group, a think-tank) were reluctant to say firmly that China's government mounted the attack on the Tibetans.

Much of the available malware emanates from China, whose 300m internet users represent the largest national group in the world. "We have reached the age of do-it-yourself signals intelligence," concludes the Canadian report.

As amateurs join the professionals, it is hard to tell whether mischief in cyberspace is the work of patriotic hackers, groups of individuals, or a government. The 2007 assault that nearly shut down Estonia's digital infrastructure was blamed on Russian ire over the moving of a Soviet war memorial. But that attack came from a "botnet"—a network of infected machines round the world—including many in America. The sale and rent of botnets is an established criminal business on the internet. An activist with a pro-Kremlin group has said that he mounted the attack on his own initiative. Other recent cyber-

attacks have coincided with conflicts between Israel and Hamas, and Russia and Georgia.

Cyberdefence efforts so far have focused on making networks more resilient. Progress on a global legal framework to control internet crime has been minimal, says a NATO cyberwarrior in Tallinn. If a host government refuses to probe further, as is the case with China, little can be done. “You need the right to send someone to the other side of the world with a search warrant to look at someone’s computer, when that person may have no idea that it is even infected,” says the official.

But it is not only governments which may need to rethink their approach. Software designers could also do more to build security into products so that computers are harder to hijack, says Shishir Nagaraja, an academic at the University of Illinois who studied the Dalai Lama’s computers.

Victims of cyber-attacks should perhaps worry less about humiliation and more about helping others to escape the same fate: a novel aspect of the Tibetan episode was that the Dalai Lama and his followers suspected their computers had been infiltrated, called in experts and then allowed the results of the probe to be published. Government and corporate leaders elsewhere might ponder his example.

Meanwhile, the furore is fuelling suspicion of Chinese motives. In Britain Huawei, a Chinese firm, is one of the main contractors in a £10 billion ($14 billion) effort to upgrade the telephone system. Huawei’s boss, Ren Zhengfei, is a former Chinese army officer, and Britain’s spies fret that network equipment that will be used by firms, households and government departments could come with hidden “backdoors” that would let Chinese snoopers evade easy detection. In 2008 America’s Congress blocked Huawei’s plans to buy 3com, another computer-equipment firm, citing similar security worries. Cyberwarfare is a business with a future.

Economist.com
WORLD
INTERNATIONAL

Religion and human rights

Diplomacy, faith and freedom

Apr 2nd 2009
From The Economist print edition

America rejoins the argument over which human rights are sacred

BACK in February there were groans of dismay among civil-liberties activists when Hillary Clinton, in one of her early pronouncements as secretary of state, suggested that America had more important things to discuss with China than human rights. “Our pressing on those [human-rights] issues can’t interfere with the global economic crisis, the global climate-change crisis and the security crisis,” she said.

But on March 31st the Obama administration did something very concrete to correct any impression that diplomatic lobbying for liberty was too big a luxury in a world with other woes on its mind. In a bid to redeem a body which sceptics had called irredeemable, it announced its intention to seek one of the 47 seats on the United Nations Human Rights Council.

The council was established in 2006 in the hope that a new structure would avoid the worst flaws of its predecessor, the Human Rights Commission, where notorious dictatorships seemed to do most of the talking. Hawks in the Bush administration were unconvinced that the council would be much of an improvement, and the council has already done much to vindicate them; it has focused far more on Israel than on any other country, and it has devoted quite a lot of energy to a campaign for laws against the “defamation of religion” whose main supporters are Muslim governments with distinctly illiberal ideas about free speech.

Still, there were sighs of relief from many other Western countries when Mrs Clinton announced that her country had decided to try joining the council and making it better. New Zealand graciously withdrew its own candidacy to make room for an American bid, in a General Assembly vote that will take place in May.

AP

A blasphemy trial in Pakistan: just whose rights are at stake?

John Bolton, who served as ambassador to the UN during the Bush administration, dismissed the American change of line as giving credibility to an agency that deserved none—or as he put it, “getting on board the *Titanic* after it’s hit the iceberg.”

Altering the council from within will be a formidable task—especially after a vote on “defamation” on March 26th which enhanced the body’s reputation as an obstacle to free expression as most Westerners would understand the concept. The resolution was passed in defiance of an appeal from a remarkably broad range of secular, Christian, Muslim and Jewish groups; in a joint statement, they had argued that by denouncing the “defamation” of faith the Council would give heart to regimes that set out to “silence and intimidate human-rights activists, religious dissenters and other independent voices.”

The International Humanist and Ethical Union (IHEU), a lobby group which co-ordinated the appeal, says the resolution is part of an effort by Islamic governments to establish a new definition of human rights which stresses the immunity of faiths from criticism, not the protection of individuals from persecution. Roy Brown, who represents the IHEU in Geneva, believes the latest resolution reflects a campaign by the Organisation of the Islamic Conference to supplant the Universal Declaration on Human Rights with the "Cairo declaration" adopted by the OIC in 1990, which lays out an alternative view of liberty.

Supporters of the Cairo statement say it complements the universal one—but as human-rights wonks have noted, the Cairo document carries the huge rider that the application of all human rights should be subordinated to *sharia* law. It also affirms the illegitimacy of "exercising any form of pressure" on Muslims to quit their faith "for another religion or for atheism"—in terms that seem to deny the individual's freedom to change religion, and to justify the penalties for "apostasy" and blasphemy that many Muslim states impose.

An unenviable task, then, for the American diplomats who face the task of arguing back in defence of old-fashioned libertarianism. But re-engaging with the council will boost America's image in many quarters—regardless of what it decides to do about a related human-rights forum: the so-called Durban II conference on racism, due to take place in Geneva in late April.

The United States said on February 27th that it was pulling out of preparations for that event: the draft final statement was too biased against Israel to be worth discussing. The text has since been shortened and made less controversial, leaving a chance that America might rejoin. But whatever America decides about that, expect some hard arguments in Geneva and elsewhere about the nature of religious freedom.

Correction: Malawi

Apr 2nd 2009
From The Economist print edition

In an article "The toxins trickle downwards" (March 14th) we wrongly said Malawi is losing a large uranium project. The project in question, called Kayelekera, is to start production shortly. Sorry.

Easier for a camel

Apr 2nd 2009
From The Economist print edition

After decades of prospering mightily, the wealthy may now be in for an extended period of austerity, says Philip Coggan (interviewed here)

Illustration by Alex Nabaun

EVEN the wealthy burghers of Monaco are feeling the pinch. At the principality's Le Metropole shopping mall the winter sales were still in full swing in early February. Upmarket retailers such as Lacoste and Christian Lacroix felt obliged to offer 50% reductions.

The rich will get little sympathy, but they have taken a big hit from the financial crisis. After all, they own a disproportionately large share of the equity and property markets. Many of them derive their wealth directly from the financial sector, working for hedge funds, private-equity firms or investment banks. A survey by Oliver Wyman, a consultancy, estimates that the financial crisis has caused high-net-worth individuals (as the banking industry calls the rich) to lose $10 trillion, or a quarter of their wealth. The annual *Forbes* list found that the global number of billionaires last year fell to 793 from 1,125, and a report by Spectrem Group, a research company, saw a drop in the number of American millionaires from 9.2m to 6.7m between 2007 and 2008.

A few businessmen who borrowed money against the security of their assets have seen their fortunes almost disappear. In Russia the number of billionaire oligarchs has halved, according to *Finans* magazine, and the assets of the ten richest tycoons have lost two-thirds of their value. Most spectacularly, one Russian businessman who had reportedly agreed to buy a villa in the south of France for €400m is in danger of losing a €39m deposit after backing out of the deal.

To many people this come-uppance of the rich will seem to be a good thing. The extremes of wealth in "Anglo-Saxon" America and Britain had reached levels not seen since the 1920s. The gains from recent economic growth flowed disproportionately to the wealthy. According to one study by Robert Gordon of Northwestern University and Ian Dew-Becker of Harvard, the top 10% of earners received the vast majority of the benefits of the "productivity miracle" of 1996-2005. Another international study found that only Mexico and Russia had more unequal income distributions than America.

Ajay Kapur, a strategist at Mirae Asset Management, dubbed this state of affairs a "plutonomy", an

economy dominated by the spending of the rich. It was a world where the wealthy might be born in France, work in London, park their money in Switzerland and have their business headquarters in the Cayman Islands. Such people seemed to inhabit a different country from other people, which Robert Frank, a writer, called “Richistan”.

That world of the wealthy emerged from economic and political changes in the early 1970s. Fixed exchange rates were abandoned, financial systems were liberalised, trade unions were confronted and taxes were cut, all of which helped usher in the asset-price booms of the 1980s and 1990s. Some of those who played the markets with borrowed money—the founders of hedge-fund and private-equity firms—became billionaires.

A rebound in profits from the low levels of the 1970s, combined with the use of share options as incentives, allowed chief executives to make fortunes. The opening up of the Russian, Indian and Chinese economies, allied to a boom in commodity prices, created a whole new batch of emerging-market plutocrats.

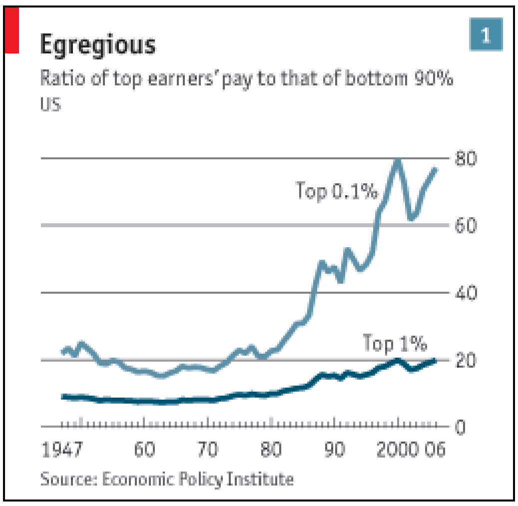
The size of the accumulated wealth was stupendous. The *Forbes* 400 richest people in 1982 had a combined net worth of $92 billion; by 2006 they owned $1.25 trillion. To make it onto the first list in 1982, you needed a net worth of $75m; by 2006 you had to be a billionaire. A lot more of this money was self-made; inherited wealth made up over 21% of the first list and under 2% of the 2006 roster. And almost a quarter of the 2006 rich owed their fortunes to the finance sector, compared with less than a tenth back in 1982.

The rich man in his castle

It would have been easy to conclude that the tide of history was simply resuming its usual flow towards greater inequality. For much of the time since records began the normal state of affairs has been extremes of wealth, whether in the hands of aristocratic landowners or industrial entrepreneurs. The period after the second world war, labelled by economists as the “great compression”, when wage differentials narrowed and taxes went up, looked like an historical anomaly.

But now the tide is turning again, reflecting widespread resentment of the mess in which the financial sector has landed the economy. The public may have been willing to tolerate extremes of wealth and pay when the economy was producing growth and jobs, but now it has become more suspicious. Why did bankers enjoy bonuses during the boom years but leave taxpayers to foot the bill during the bust? Why should companies be allowed to dodge taxes and sack workers by shifting operations overseas?

What is happening now could mark one of those sea changes in public policy that seem to come along once in every generation. In the late 19th and early 20th century a decline in American farm incomes prompted a rise of populism and progressivism that led to attacks on corporate trusts in America under Theodore Roosevelt. In the 1930s the Depression led to the New Deal and the re-regulation of the financial sector in America, and the rise of fascism in Europe. Reaction to the economic crisis of the 1970s ushered in the Thatcher and Reagan reforms.



Governments are already trying to deal with public anger about manifestly unfair gains by capping bankers’ bonuses. The level of regulation will increase, and taxes will inevitably rise as governments struggle to contain their bulging budget deficits. As President Obama’s budget proposal showed, the rich will be tempting targets for those tax hikes.

It is also possible that globalisation may come under threat as governments seek to placate their voters by protecting local jobs and industries. Already banks are being urged to lend money to domestic rather than foreign businesses. The German and American governments are leading an attack on bank-secrecy laws in tax havens. The elite may no longer find it so easy to move itself and its capital from country to country, depending on where the returns are highest and the taxes lowest.

All this may bring a reduction in inequality, especially in the Anglo-Saxon economies where it seemed to have increased most. The big question is whether this will be short-lived, linked solely to the crisis, or

turn out to be something more structural. Social safety nets are much better developed than they were in the 1930s, which may make the poor less desperate and constrain their anger at the rich. But the search for scapegoats will be on.

For the moment the pressure is being felt by businesses that service the rich. Ferretti, a top-of-the-range yacht manufacturer, has defaulted on part of its debt; creditors are set to get just 11 cents on the dollar. The decision by Saks, an exclusive retailer, to slash prices during the 2008 holiday season caused consternation among some luxury-goods groups. Sales at Tiffany's American jewellery stores have plunged. De Beers has suspended production at one of its biggest diamond mines.

And even wealthy people who are not feeling the pinch may have become more cautious about spending ostentatiously. Net-a-Porter, an upmarket fashion website, now offers the option of having designer outfits delivered in a brown paper bag.

Fee for no service

Those who look after rich clients' wealth are already in trouble. Surveys indicate that the better-off are highly dissatisfied with the service provided by their private banks, which failed to protect them from the market falls of the past 18 months. The fraud that caused investors who handed their money to Bernard Madoff to lose tens of billions of dollars has raised new doubts about the safety of portfolios and about the due diligence undertaken by wealth managers.

All that said, there are still plenty of rich people around. Someone was confident enough to pay $20m for a Degas bronze at an auction at Sotheby's in February. Diners at the Hotel Metropole in Monaco are still willing to shell out €137 for a grand dish of rock lobster.

But the outlook for the rich is no longer the "glad, confident morning" that it seemed just two years ago. In a survey of high-net-worth Americans by Harrison Group in January, 78% said their sense of financial security had been undermined by the crisis; only 46% were optimistic about their own future, against 93% in 2005.

This special report will explain how disparities in wealth and income became so wide in the first place and ask whether that process will now go into reverse. And it will examine how well the rich are coping with the crisis—because that will matter for everyone else too.

Show them the money

Apr 2nd 2009
From The Economist print edition

The rich have become disillusioned with the people who look after their fortunes

Illustration by Alex Nabaun

ONE of the problems with being rich is that you cannot just leave your money to sit there: you have to do something with it. Few people feel confident enough to throw themselves into the hurly-burly of financial markets on their own. The wealth-management industry exists to take that problem off their hands, for a pretty hefty fee.

Unfortunately for all concerned, the industry tends to promise more than it can deliver. Last year was disastrous for financial markets, with the MSCI World index of equities falling 42%. Moreover, many clients, having been persuaded of the benefits of diversification in recent years, had bought alternative assets, such as hedge funds and private equity, which supposedly offered absolute (positive) returns uncorrelated with the stockmarket. But when the crisis came, those assets turned out to be highly correlated to the mainstream and lost value as well.

The final straw came at the end of last year when the extent of the Madoff scandal was revealed. Bernard Madoff pleaded guilty to running a Ponzi scheme in which he was paying early investors consistent returns by taking the money from later ones, with potential losses in the tens of billions of dollars. Just what were wealth managers doing to earn their fees if they could not spot the scam?

So there is now fairly widespread dissatisfaction with the industry. “The old wealth-management universe is not just broken, it’s been broken and tossed away,” says Russ Prince of Prince & Associates, a market-research firm. “Nobody believes anything anybody is saying any more.” A survey by his company showed that 15% of the wealthy had left their main adviser last year and a further 70% had pulled some of their money away.

A survey of rich Americans by Harrison Group found that 63% had lost faith in financial institutions. And Caroline Garnham of Lawrence Graham, a London law firm, says that half of her clients do not use private wealth management at all, and half of the remainder are dissatisfied with the advice they received.

The private wealth-management business has always been rather murky. Ask for performance figures, and the best you will get is the record of some model portfolio; clients are all different, managers say, and have different attitudes to risk. Besides, they argue, looking after a client is not just about performance, it is also about tax management, family structures and all manner of other things. Some clients have strong opinions and will want a say in how the portfolio is run; others will have long-standing positions in particular businesses or properties that they may be unwilling or unable to sell. So a private-client portfolio will normally look quite different from a pension-fund version with its careful mix of equities, bonds and property.

These constraints are real enough, but they make it very hard to measure the “success” of a private-client manager. A lot may depend on the trust between the individual client and the relationship manager at the bank; if the bond is strong, then a bad year such as 2008 can be explained away. This can be an advantage to private banks once clients are on the books; inertia may keep them there, if only because clients can rarely be sure that they would be better off elsewhere.

Who rates as rich?

How much money do you need to count as wealthy in the first place? For a wealth manager, it depends on how big a portfolio you can give him to manage. For example, Merrill Lynch's wealth-management report starts counting at $1m in "investible assets". That excludes people's main homes, which may seem reasonable. But it means that a Londoner who sells his home and decides to rent can suddenly find himself "rich".

In fact, a lot of wealth managers will not bother with anyone who has less than about $10m in assets. After all, a portfolio of $1m these days would generate an income of only $30,000 if invested in Treasury bonds, which does not leave much scope for the playboy lifestyle.

Putting performance to one side, another big issue for the industry is the quality of advice on offer, and whether it is sufficiently impartial. In many cases private banks may be part of larger groups that see an advantage in having a captive client base for their other activities. This link is made explicit in a recent report on the wealth-management industry by Boston Consulting Group (BCG). "Some players position their private banks within their corporate or investment banks," the report says. "This approach aims to keep the client's wealth in a single institution and tap product-development synergies."

These synergies often turn out to benefit the banks a lot more than the clients. As Stefan Jaecklin of Oliver Wyman puts it, "in the integrated banking model there are limited benefits for the private bank from having an investment bank attached; the benefits mainly flow the other way round. A lot of private banking has not been about advice but about pushing products. Often bankers will be rewarded not just on the basis of assets under management but on product sales."

Jacques de Saussure of Pictet, a Swiss wealth-management group, agrees. "We have avoided having an investment bank within the Pictet group because it creates lots of conflicts of interest," he explains. "The wealth-management business can become a distribution channel."

An important development in recent years has been the use of so-called structured products. Like the toxic versions that were undone by the collapse in the American housing market, these products involve the use of derivatives. That makes them a tempting sales opportunity for investment banks with derivative expertise. An enthusiast would say that these products often have tax advantages and can be used to manage an investor's risk profile; a cynic would say that the structures can disguise a lot of fees and charges.

A gamble by another name

Some structured products may be a reasonable way of enticing investors to take a bit more risk; for example, with an investment that offers 90% of the growth in an equity index but with a guaranteed return of capital if the market falls. But others, particularly those involving commodities, may be a vehicle for gambling. "A lot of structured products were speculative in nature, with questionable purpose in a private-banking context," says Mr Jaecklin.

These structured products can quickly turn into dead money if markets move against them, with clients locked in for years or able to redeem only at fire-sale prices. "Structured products can become illiquid and pricing can be at the mercy of the issuer," says Pictet's Mr de Saussure.

Another issue emerged from the collapse of Lehman Brothers. In some cases the guarantee on a structured product was provided by the failed investment bank; this meant that clients did not get their promised money back after all.

But the bigger problem has been investment losses. During the boom years some Asian private-banking clients were sold a toxic product known as an accumulator. The structure sounded simple. If shares in a company, say General Electric, stayed above a given level, investors received a high yield; if the shares dropped below that level, they ended up owning the stock. In effect, the clients had written a put option on the share price. That was fine in rising markets but proved to be a disaster in 2008 when clients ended up owning shares that were falling rapidly.

Asian clients may have been sold more of these products because they were generally seen as being willing to take rather more risk. As one observer remarks, many of these clients were people who were earning 25% a year from their own businesses; they found it hard to understand why private banks were offering much lower returns. Raj Parmar of HSBC Wealth Management says there was "little doubt that the Asian wealthy did exceptionally well in the past five to seven years and better than their counterparts

around the world. However, a lot of institutions were knocking on their door and outbidding each other on returns, often using leverage. By late 2008 many Asian investors gave away a substantial proportion of the profits they made in those five to seven years."

Many Asian clients will have been caught out by the sharp falls in local markets last year, with the Shanghai A share market dropping by 65%. Even so, the industry sees the region as a promising area for expansion. According to BCG, assets under management in China grew at a compound annual rate of 25% between 2002 and 2007, though the figure will have taken a big hit in 2008. Another growth area was central and eastern Europe, which had four of the ten fastest-growing wealth markets in 2002-07: Poland, Slovakia, Hungary and the Czech Republic.

Wherever the clients are based, they are likely to have been chastened by the experience of the past 18 months. Like everyone else, rich people want the impossible: high returns with no risk. But their biggest fear, naturally enough, is losing a chunk of their wealth so large that they would have to adjust their lifestyles to live on a smaller income. So at times of trouble they will retreat from risky assets such as hedge funds and into cash and government bonds. Some have called it the "back to basics" market. "For the next 18 months to two years, investors will be a little cautious," says HSBC's Mr Parmar. "They are going to demand more explanation of what is in their portfolios. It is hard to sell a black-box product today."

Golden glow

Indeed, there is considerable demand for that most ancient of financial products, gold. According to the World Gold Council, investment demand for bullion between 2007 and 2008 rose by 64%. Pictet, the wealth-management group, decided some time ago to take physical delivery of gold (rather than get exposure via the derivatives market), and has had to find extra space in its vaults.

This change in behaviour is, in itself, a challenge for the private-banking sector. Oliver Wyman suggests that the shift from equities and structured products into cash and fixed income will reduce private-bank revenues by around 20%.

Moreover, the Madoff scandal and the controversy surrounding Sir Allen Stanford, a rich Texan accused of an $8 billion investment fraud, raises a lot of questions about what private wealth managers actually do with their clients' money. How could such groups pass due-diligence tests when they used obscure auditing firms and kept their investment processes so secret? According to Jérôme de Lavenère Lussan of Laven Partners, a company that specialises in due diligence, "there has been a degree of complacency and laxness about how people choose investments."

There may well be some consolidation in the fund-of-hedge-funds industry, where many people have been amazed to find that managers charged 1% or 1.5% of the sums invested a year for their supposed skill in scanning the industry, only to send clients' money to Mr Madoff. With the sector already losing money after suffering unexpected losses in 2008, many funds-of-funds may be forced to close. "We expect that firms which suffered from exposure to Madoff (almost regardless of the scale) will see material redemptions as investors react to perceived lapses in the due-diligence process," says Huw van Steenis, a finance-sector analyst at Morgan Stanley.

The rest of the wealth-management industry may also have to change. Fees have not been transparent, with clients getting charged for a whole range of services and some managers taking "retrocessions" or kickbacks from outside funds with which they place money. "The industry needs to move to a model where advice is being charged for and money flows are transparent," says Mr Jaecklin.

Downward pressure on fees seems inevitable. In the 1990s, when investors were earning 20% a year, fees seemed a trivial issue; but when cash is yielding 1-2% and government bonds 3-4%, they take a much bigger chunk of total return.

Given their losses in 2008, clients may also be attracted to banks which they believe to have weathered

the crisis better than others; Credit Suisse and JPMorgan are both reporting significant inflows. Another section of the market that may do well is private family offices, which deal with the wealth of a single dynasty or a small group. Their main drawback is that they require considerable resources to set up, so may not be worthwhile unless a family has around $1 billion. Multi-family offices, such as the London-based Fleming Family & Partners, are another option.

There is a natural inertia about wealth management. Clients may want to believe that they made the right choice of adviser in the first place, or will "cling to nurse, for fear of finding something worse". They may also feel they lack the expertise to evaluate the service they are getting. "Private clients don't know enough about the industry to be able to demand what they need," says Ms Garnham. But the financial crisis will have shaken many clients out of their lethargy. The next few years will see big changes in the wealth-management industry. In future, firms will have to deliver as well as promise.

Economist.com SPECIAL REPORTS

Bling on a budget

Apr 2nd 2009
From The Economist print edition

Designer belts are being tightened

Illustration by Alex Nabaun

A WEALTHY Mexican walked into an exclusive shop in Vail, Colorado, late last year and picked out $11,000-worth of clothes to lay on the counter. He perused them for a minute, then offered the sales assistant $6,000 for the lot. The shop countered with an offer of $6,800.

The rich are economising, and the businesses that deal with them are having to cope. In a survey of wealthy individuals conducted by Harrison Group, 80% said they were looking at each spending category to see what they could save, 77% were buying fewer big-ticket items and 78% were waiting for the sales before buying such items. Across the board, Harrison's Jim Taylor reckons the wealthy are spending 30% less than before, the sole exception being items for their children.

Claudia d'Arpizio of Bain Consulting reckons that the luxury-goods market probably grew by only 1% last year, having suffered heavily in the fourth quarter. A dramatic estimate of the decline during the holiday season was made by SpendingPulse, part of the MasterCard credit group, which calculated that luxury-goods spending between November 1st and December 24th 2008 was down 34% year-on-year. Bain thinks the first half of this year will also look grim.

The effects are showing up across the industry. Bulgari of Italy reported a 17% drop in jewellery sales and a 28% decline in watches in the fourth quarter; Tiffany's said sales in its American stores dropped 35% in November and December; Richemont, a Geneva-based group with brands such as Cartier, saw its sales fall by 12% in the three months to December. LVMH did rather better than the rest, reporting revenue growth of 4% in the fourth quarter, although the watches and wine divisions suffered small drops year-on-year.

Moreover, shoppers for luxury goods can be frustratingly inconsistent. Although the overall trend is down, demand in one shop can be up 50% one day and down 50% the next. Manufacturers and retailers find it hard to budget or plan stock levels.

The wealthy are cutting back on leisure spending as well. According to Smith Travel Research, in the week ending February 21st occupancy rates in luxury hotels were 17.5% down on the same period in 2008, and revenue per room was 27.5% lower. That has caught out some hotel owners who took on too much debt; in Colorado, the owner of the Vail Plaza Hotel & Club filed for Chapter 11 bankruptcy in October.

Vivian Deuschl of the Ritz-Carlton hotel group says corporate bookings have been particularly badly hit. This has become known as the "AIG effect", after the insurance group that was rescued by the American

government last autumn and several times more since. Shortly after the first bail-out it emerged that the group had spent $440,000 on a spa retreat for salesmen. Political outrage at the junket led other companies to rethink their plans. “Even if businesses have money,” says Ms Deuschl, “they are very skittish about spending it at luxury hotels.”

In addition, the conference market is taking a hit because of the business downturn. The Fairmont hotel in Monte Carlo, which is close to the Grimaldi conference centre, says events are being booked at much shorter notice. Some hotels are reacting to this by trimming non-essential spending; using potted plants as decorations, for example, instead of fresh flowers that have to be replaced every day.

Just like flowers, servants are being pruned. David Gonzales of the Domestic Placement Network in southern California says that a number of chefs have lost their jobs. Live-in chefs are very expensive to maintain and their employers can economise by eating out more, entertaining less and using contract caterers when they have dinner parties at home.

Nor has the crisis driven the wealthy to drink. Champagne exports fell by 4.8% last year. An index of fine-wine prices dropped by 18% after the Lehman Brothers collapse; Simon Staples of Berry Bros & Rudd, a London-based fine-wine merchant, says that some prices have dropped by 40%. But that still leaves the prices of some vintages, such as the sought-after 2005s, well above their initial levels.

Flash fatigue

There seem to be two main reasons why the wealthy are tightening their purse strings. The obvious one is the hit to their portfolios from the equity and property markets. “It’s not just that they’ve lost money,” says Russ Prince of Prince & Associates. “They’re not sure how much more they’re going to lose.”

The second reason is a feeling that it is wrong to show off at a time when the economy is in recession and people are feeling poor. Conspicuous consumption is out. The top end of the watch market is suffering, not least because such watches are often bought out of bonuses in the financial sector, which have largely dried up.

Mr Taylor of Harrison Research points to a boom in sales of used luxury cars. “You don’t want to pull up in your driveway with a new Mercedes when you know your neighbour is suffering.” Tastes may shift from the flashy to the practical; cashmere knitwear may still be acceptable whereas extreme fashion is not.

All this comes after many boom years in the luxury sector. An indication of the demand for top-of-the-range goods can be found in *Forbes* magazine’s “cost of living extremely well” index which includes items such as facelifts, fur coats and Gucci loafers. It almost quadrupled between 1982 and 2006, whereas the broadly based consumer-price index merely doubled.

Stephen Abery of the broker Fraser Yachts says that roughly half of the world’s 100 biggest yachts have been built since 2000. Some are more than 150 metres long, half as much again as a football pitch. Even a 70-metre version could cost €100m to build. And what with a dedicated crew, mooring, fuel and insurance, the annual running costs will be in the millions.

The cost of finding trained crew has gone up sharply in recent years, says Mr Abery, although the trend has softened recently. Wages for domestic servants have also shot up: Mr Gonzales says demand has tripled in recent years. Steven Ferry of the International Institute of Modern Butlers says there has been a big jump in the use of butlers in hotels, where they serve the occupant of a suite or a range of suites.

It is not quite a return to the world of P.G. Wodehouse’s Jeeves (a valet, not a butler), who looked after Bertie Wooster. Modern butlers often act as household managers rather than serving up drinks on silver trays. Their employers tend to be asset-rich and time-poor and need staff to maintain a range of properties.

The market for luxury goods and services is highly stratified. There is a big gap between those who can afford a butler and those whose only foray into the market is to buy a Gucci handbag. Marc Cohen of Ledbury Research points out that the high-profile wealthy make up only 0.1% of consumers; luxury-goods groups have to aim a bit wider to do well. But expansion can create a dilemma. If it is overdone, a brand can lose its cachet.

Guy Salter of Walpole, a British luxury-goods association, says the industry has done so well for so long that it lost sight of some of the issues. "A hundred years ago luxury-goods manufacturers were small family-owned businesses who knew their customer base very well. By the 1970s and 1980s there were lots of people flocking to buy luxury goods who were happy to pay for the flash and the logo. The companies stretched the elastic too far," he argues.

Crafting a new strategy

The recession may cause manufacturers to rethink their strategy. Ledbury's Mr Cohen says the wealthy may decide they will buy fewer things but will go for higher quality: less bling and more craftsmanship. This may favour a group such as Bottega Veneta which produces handbags without a logo but with a distinctive stitching pattern.

Another group that thinks it can benefit from the change in mood is NetJets, which allows both the rich and the corporate elite to fly privately without the expense of owning their planes. The company says the average corporate client spends €700,000-800,000 a year, compared with the €17m-18m it would cost to buy a mid-size jet. NetJets is hiring 12 new salespeople in a bid to capture market share; it may be helped by the fact that owning a jet has come to symbolise corporate excess.

Most companies associated with the luxury-goods market, however, will have to adjust to a decline in demand. Mr Salter says that manufacturers cannot react to the squeeze by cutting costs unless they can maintain quality. "Integrity comes from having craftsmen," he says. "The wealthy are not going to economise on good taste."

Luca Virgilio, who runs the Hotel Metropole in Monaco, says it would be a mistake for him to compromise on quality; clients visit the hotel precisely because it is luxurious. Rather than cutting prices, the hotel is offering more services for the same price in an effort to keep clients loyal.

It is a tough call to make. Keeping standards and prices high maintains elite appeal but risks losing some customers to lower-cost alternatives. What makes the call even more difficult is that the ranks of the rich have changed over the past 20 years; old money has become less important. "A lot of the wealth of the past 20-30 years is self-made and they are looking for value," says Walpole's Mr Salter. "Most of even the super-rich were middle-class 20 years ago."

Cheap thrills

Retailers' plans were thrown into disarray when Saks Fifth Avenue decided to cut prices on designer clothes by up to 70% even before the start of the holiday season (defined as Thanksgiving to Christmas). The strategy helped Saks avoid being burdened with excess stock in January, but rival shops were made to look very expensive and felt they had to follow suit.

Nordstrom, a department-store group, reported a 68% fall in fourth-quarter net profit, thanks to a decline in margins prompted by price cuts. The markdowns solved the immediate problem of excess stock but did nothing to solve the medium-term issue of slumping demand; the Seattle-based retailer is forecasting a 10-15% decline in same-store sales this year. There is also the longer-term question of whether consumers might get hooked on price cuts. "The very big discounts by department stores may have created a dangerous attitude in shoppers, that it is a little bit irrational to pay the full price," says Bain's Ms d'Arpizio.

Many of the wealthy may be migrating to the internet. Mr Salter cites a survey showing that they are happy to buy online; some 40% said they preferred net-based shopping because they felt uncomfortable going into luxury-goods stores. But online shopping holds its own dangers. Last year a French court fined eBay €40m for allowing auctions of fake luxury items on its site. The problem of counterfeiting may get worse as wallets get squeezed.

Senior people in the industry admit this is going to be a very difficult year. The best they can hope for is that the rich will concentrate their spending on the highest-quality stuff. Cutting corners can be a false economy; a cheap handbag, one expert argues, can drag down the rest of a woman's outfit. Manufacturers think it is better to accept lower sales than lower margins. They worry that just by trying to get through 12-18 months of crisis, they might be ruining their brands. But it is a big bet, and some of

those brands will not survive.

A thing of beauty

Apr 2nd 2009
From The Economist print edition

The best works of art still command fancy prices

IN CHRISTIE'S Paris auction room on the evening of February 23rd it was as though the financial crisis had never happened. A sale of works of art collected by the late designer Yves Saint Laurent brought in $264m, well ahead of the estimate of $232m (though a Chinese buyer refused to pay for some bronzes as a nationalist protest). Records were set for works by Piet Mondrian and Marcel Duchamp, although a Picasso failed to meet its reserve price and was withdrawn.

At Sotheby's, meanwhile, sales of Impressionist, modern and contemporary art in February raised $100m, including a record £13.3m ($20m) for a Degas sculpture. The same piece had been bought for $9.1m in 2004.

But the art market has hardly come through the crisis unscathed. Ian Peck of the Art Capital group reckons that prices have dropped by 20-30%, with the contemporary market particularly badly hit. His group, which lends money to art buyers, has reduced estimated values of collateral by up to 50%.

What the February auctions showed was that there is still money around to bid for exceptional pieces. But the auctioneers are being much more selective about the works they are offering for sale and have abandoned the boomtime practice of guaranteeing prices. These attracted buyers and allowed auctioneers to take part in the upside, but carried a big risk when the market turned.

That risk has duly surfaced. Sotheby's reported a 52% decline in revenue in the fourth quarter of 2008, with a 46% fall in auction sales. The company reported "significant auction-guarantee losses and inventory writedowns" and is cutting its staff by 15%. "We are forecasting lower sales volumes for 2009," says Ed Dolman, chief executive of Christie's. "But there have been seen some very high prices paid for individual items, including the highest price ever paid for a diamond."

Some buyers, such as the hedge-fund titans, may have been hit by the financial crisis, but the art world has yet to see a lot of forced sales. "The market is driven by the Ds, death, debt and divorce," says Mr Dolman. "There is a fourth D, discretionary selling, but there has not been much of that so far."

The previous art-market downturn was 20 years ago, after record prices were paid for Impressionist works, including $54m for "Irises" by Vincent van Gogh. The buyer of that work, Alan Bond, an Australian tycoon, turned out to have borrowed part of the purchase price, and struggled to repay the loan after his business empire collapsed. At the time he was competing for the paintings with a group of Japanese buyers whose fortunes had been boosted by the boom in their country's land and share prices in the late 1980s. When the Japanese economy slumped in the early 1990s, the art market fell back sharply.

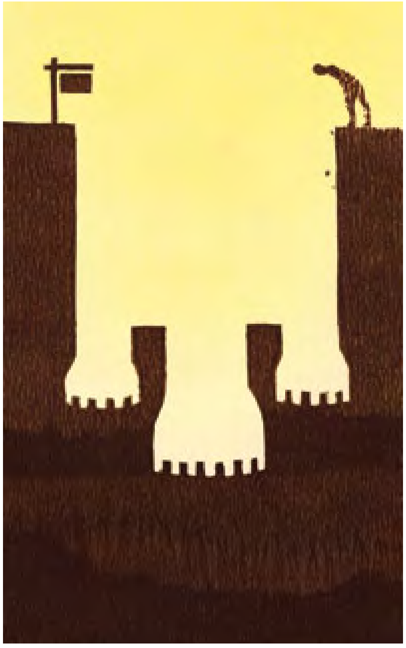
Art-buying during the recent boom has been far more broadly based, taking in Asia, Russia and the Middle East. The Russians may now have receded again, but art experts hope that the rest of the market will prove more resilient this time.

Dropping bricks

Apr 2nd 2009
From The Economist print edition

A runaway boom in property prices has gone into reverse

Illustration by Alex Nabaun



IF ANY market has been distorted by the activities of the rich over the past decade, it must surely have been property. For a while it seemed as if the plutocrats were competing against each other to pay the silliest prices for the smartest locations.

Even though prices are now retreating, in some areas they still seem over the top. A two-bedroom apartment in Monaco shown to *The Economist* did have a view of the bay, but it was not helped by an elevated highway bang in front and a noisy building site next door, and the kitchen was tiny. The price was a staggering €8m, enough to buy three or four substantial houses in, say, west London.

But the rich do not want to live in the wilds of west London. Estate agents in that city say they balk at any property more than 800 yards from Hyde Park Corner. In New York the wealthy want to live either by Central Park or all the way out in the Hamptons; in Europe they aim for Monaco or the French Alps. Combine a limited number of preferred locations with the massive increase in wealth over the past 20 years and you get ridiculous prices.

Monaco's property market benefits from a shortage of space and tax advantages so persuasive that foreign residents far outnumber the locals. Last year it became the world's most expensive residential location measured by price per square metre, according to a survey by Knight Frank, a firm of estate agents (see chart 3). The prime areas of London slipped into second place because of the weakness of the pound. But even Monaco's market is suffering. Pascal Chaisaz of Savills, another estate agent, says that during the frenzy of 2006-07 prices reached €100,000 per square metre. They have now fallen back to €50,000, but that is still a lot more than the €15,000-20,000 at which they traded six or seven years ago.

The curse of Lehman

The price of a smart address 3

Prime residential property, Q4 2008

	€ per sq m	$ per sq ft
Monaco	50,000	6,550
London	28,000	3,670
New York*	16,500	2,160
Moscow	16,200	2,120
Paris	16,000	2,100
Tokyo	15,850	2,080
Hong Kong	15,750	2,070
Rome	13,500	1,770
Singapore	11,850	1,550
Sydney	11,000	1,440

Source: Knight Frank Residential Pricing *Manhattan

Agents generally agree that the top end of the market was doing very well until September 2008 when Lehman Brothers went to the wall. Liam Bailey of Knight Frank says that in the first half of 2008 the group sold twice as many houses in the £10m-plus category as it did in the first half of 2007. But the super-rich segment of the market has since dropped as steeply as anything else.

Knight Frank says that 37 of the 55 prime international locations it covers saw price falls in the last quarter of last year compared with a year earlier. Hong Kong, London, Singapore and Sydney all suffered double-digit declines over that period. The hardest-hit market may be Dubai, which indulged in a flurry of building in recent years in its bid to become a global financial centre. As speculators have fled the market, some prices have fallen by 50%.

Pamela Liebman of the Corcoran Group says the market in Manhattan has suffered as well. Bonuses in the financial sector have either fallen sharply or disappeared altogether, and hedge funds are struggling. Moreover, in a new spirit of discretion, buyers do not want to see their names publicly associated with a

high-priced purchase; they are trying to do deals below the radar. Ms Liebman estimates that prices for the most expensive properties in New York have come down by 20-30%; in the Hamptons, where the rich have their summer homes, some buyers are making offers 40% below the peak. But, she adds, “there is a real disconnect between what buyers are willing to pay and what sellers will accept.” That has led to a big fall in transaction volumes.

Other smart addresses are also suffering. In Vail, Colorado, the number of transactions in December 2008 was the lowest for any month since the Land Title Guarantee Company began tracking deals in 1996; in nearby Aspen the local Sotheby’s International Realty office has closed. In California sales of million-dollar homes fell by 43% between 2007 and 2008, according to MDA Dataquick, with sales in Beverly Hills dropping by 30%. In February the Beverly Hills city manager was forecasting that the property downturn would cause an imminent 15% drop in tax revenues.

Manhattan and London are clearly affected by the downturn in the financial sector. But the uppermost end of the London market, argues Yolande Barnes of Savills, prospered until September last year because it was the preserve of the international wealthy. However, even the very rich now seem to be affected by the gloom. Russian buyers seem to have vanished altogether, whether in London, Manhattan or Monaco. There is now much scepticism about the plans of the Candy brothers, a firm of British developers who have been trying to create a new class of property with luxurious fittings and abundant services suitable for the global elite. Will the rich still be willing to pay a premium for such places?

Although the very wealthy can pay cash for their homes, they often do not want to tie up too much of their capital that way. But borrowing has become a lot more difficult. Simon Gammon of Knight Frank says that British banks now like to see a 60% loan-to-value ratio, rather than the 75% they would have accepted in the old days; and the spreads against LIBOR (the banks’ benchmark rate) have risen. Some banks now try to use mortgages as quid pro quo for other business opportunities; for example, clients may be required to place money with their wealth-management arms before they are given a loan. Ms Liebman says American banks are also being more cautious, particularly about allowing for bonuses when calculating bankers’ incomes.

Forecasting the bottom of the market is a tricky task, particularly at the prime end. For highly prestigious properties, valuation measures such as price per square metre are only an approximation. Paying $20m for an apartment might seem absurd to most people but would represent only a small part of a billionaire’s portfolio.

Pride before the fall

Nevertheless, it was clear that the prices of the best properties became inflated. In 2007 Tim Blixseth, a luxury-resorts developer, advertised a 160-acre property near Bozeman, Montana, part of the Yellowstone Club, at a remarkable $155m. The resort has since gone into bankruptcy. The property was never built and the lot was sold for $10m.

Peter Mackie of Property Vision thinks that London prices could easily fall 50% from their peak. The market did very little in 2001-05, he says, and then took off with a whoosh because of bonus money. According to Savills’ global residential review many markets have seen a decade of price rises of 10-20% a year. “Against such a backdrop, even today’s largest falls of 50% in some cases will still leave a long-term legacy of substantial price growth,” says Charles Weston-Baker, director of Savills’ international residential department.

More or less equal?

Apr 2nd 2009
From The Economist print edition

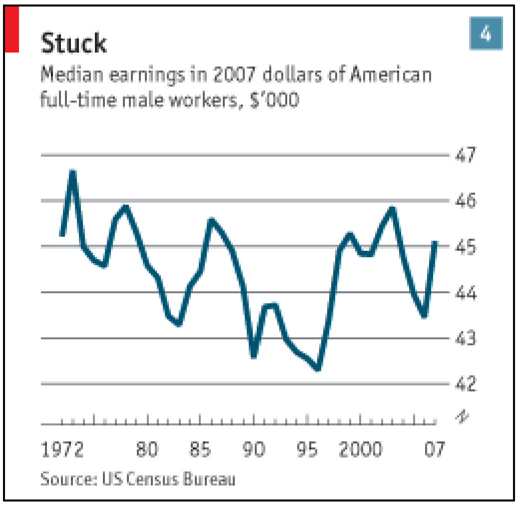
The gap between rich and poor has been widening for 30 years. It has started narrowing again

Illustration by Alex Nabaun

THE past 30 years have been a great time for the wealthy. Their businesses became more profitable; their equities and properties increased in value; for those who worked in investment banking or hedge funds, bonuses rose steeply. And the further up the income scale you went, the better the rich did. Just as the bottom 90% of the population have lagged far behind the top 10%, most of those in the top 10% have trailed the elite 1%. And that select 1% has looked in envy at the Croesus-like 0.1% at the very top of the tree.

Any explanation for this rise in inequality needs to account for several different trends. In the 1980s the poor fell further behind the middle classes, but since the 1990s those middle classes have been squeezed. Both groups have lost ground to the elite. Between 1947 and 1979 the top 0.1% of American earners were, on average, paid 20 times as much as the bottom 90%, according to the Economic Policy Institute, a think-tank in Washington, DC; by 2006 the ratio had grown to 77. In 1979, 34.2% of all capital gains went to the top 1% of recipients; by 2005 the figure was 65.3%.

All this happened during a period when American workers' median real incomes stagnated (though the notional value of any health insurance would have risen steeply). In 2007, according to the Census Bureau, the median income of American male workers was $45,113, less than the $45,879 (in 2007 money) that they earned back in 1978 (see chart 4). At no point over that 29-year period did median incomes pass the $46,000 mark. Families made ends meet because more women worked (and their real incomes did rise) and because they were able to borrow money to maintain their spending.



The classic tool for measuring inequality is the Gini coefficient. The higher it is, the less equal the society. In America the coefficient climbed steadily from 0.395 in 1974 to 0.47 in 2006 before dipping slightly to 0.463 in 2007. In Britain, according to the Institute for Fiscal Studies, the Gini has risen from 0.25 in 1979 to 0.35 in 2006. Figures from the United Nations suggest that America's Gini coefficient is lower than that of many developing countries but well above the levels recorded by egalitarian Denmark, Finland and Sweden, where it does not seem to have risen much.

The recent widening of inequalities marked a complete reversal of the previous trend. From the 1930s to the late 1970s wealth disparities in developed countries declined sharply. But which is the anomaly: the

earlier period of high tax rates and rapidly growing state involvement in the economy, or the rising inequality of the past 30 years?

The norm and the exception

Historically, it seems that the rich, like the poor, have always been with us. Even so, the change of course in the 1980s calls for an explanation, as does the fact that inequality has risen far more in some countries than in others. There is a clear gap between America's and Britain's "Anglo-Saxon" model and the rest.

That makes some explanations for the widening disparities look suspect. One is the widespread use of technology, which might be expected to favour those workers who are able to exploit it. But the Nordic economies are well up on technology; Finland, for instance, is home to Nokia, a huge mobile-telecoms group. Technological change may explain why unskilled workers have lost ground to graduates. But it does not explain why such a wide gap has emerged at the very top of the income scale, with the top 0.1% outpacing other professional workers.

The disappearance of the ultra-high tax rates that were prevalent in the 1970s helped the rich hang on to their gains. But work by two academics, Thomas Piketty and Emmanuel Saez, shows that inequality has been just as marked in pre-tax as in post-tax incomes. And why did governments propose (and voters approve) such tax cuts in the first place? There was a feeling in the 1970s that the post-war economic model had been corroded by rising inflation and a series of oil shocks. That helped prepare the ground for the Reagan and Thatcher reforms.

As for inequality lower down the scale, a study of the literature by Robert Gordon and Ian Dew-Becker cites the decline in trade unionism as a big factor, at least for men. In 2005 only 14% of American workers were union members, compared with 27% in 1979. The decline in unionisation may also help to explain the political acceptance of the low-tax, low-regulation regime. Political parties are no longer as dependent as they were on union donations. Instead, they have had to cultivate the rich, who have gained greatly in lobbying power. A study in the late 1990s of congressional elections found that 81% of political donors earned more than $100,000 a year and only 5% earned less than $50,000.

The free-market consensus among parties in Western countries increased disillusionment among the poor, who felt they lacked any real choice between economic policies. That, in turn, made them less likely to cast their vote.

Domestic politics is clearly not the only factor. Many people would point to globalisation, in particular the opening up of the Indian and Chinese markets that vastly increased the global labour force, putting downward pressure on unskilled wages. But academic studies have not found this to be a big factor in explaining the level of wages for the unskilled in recent years.

Globalisation may, however, explain some of the changes at the very top of the scale. The emergence of a global market for talent in areas such as banking, the law and investment may explain why the top 0.1% have been so well rewarded.

Illustration by Alex Nabaun

In particular, the financial sector contributed an increasing proportion of stockmarket profits from the early 1980s to 2006. The greater acceptance of debt allowed private-equity firms and hedge funds to bet on rising asset prices with borrowed money, which is a quick route to riches when all goes well. There were plenty of incentives to take risk, in the expectation that someone else would pick up the tab when things went wrong. The willingness of central banks to use interest-rate cuts to bail out financial markets only added to the speculative enthusiasm.

Messrs Gordon and Dew-Becker point to the rise of "superstar" labour markets in which the best talent commands a huge premium. The clearest examples are found in entertainment and sport. Name recognition gives an exponential kick to the incomes of celebrities like Madonna or David Beckham who can attract endorsements, souvenir sales and the rest. In financial markets, those who mastered the sophisticated instruments (such as derivatives) that emerged in the era of liberalisation were also able to cash in.

The halo effect

Another group of beneficiaries, chief executives, may be in a different category. They benefited from the early use of share options in America, which gave managers a geared play on the 1980s and 1990s bull market. Messrs Gordon and Dew-Becker are not sure whether the resulting wealth was due to their executive skill or to their ability to control boards and thus the amount they got paid. Some executives enjoy a "halo of reputation", the academics suggest, that causes directors to shower them with vast rewards when an equally capable but less famous alternative might have been willing to do the job at a small fraction of the price.

One thing holding back such executives was "outrage constraint", a fear that massive pay packages might attract unwelcome attention in the media. That may have led to an attempt to disguise executive pay, with the really big increases being awarded in the form of option grants and deferred compensation and benefits.

Spurs to effort

Leaving aside the moral issues, does inequality have any economic benefits? In the 1970s it was argued that high taxes had reduced incentives and thus economic growth. Entrepreneurs had to be motivated to build businesses and create jobs. But extensive study by economists has found little correlation, in either direction, between inequality and economic growth rates across countries.

One argument advanced in America is that wide income disparities might encourage more people to want to go to college, thus creating a better-educated workforce. But Lawrence Mishel of the Economic Policy Institute points out that several societies that are more egalitarian than America have higher college enrolment rates.

There might also be an argument in favour of wealth disparities if social mobility was high and the sons and daughters of office cleaners could fairly easily rise to become chief executives. But America and Britain, which follow the Anglo-Saxon model, have the highest intergenerational correlations between the social status of fathers and sons; the lowest are found in egalitarian Norway and Denmark. Things are even worse for ethnic minorities; a black American born in the bottom quintile of the population (by income) has a 42% chance of staying there as an adult, compared with 17% for a white person.

As a result, talent is being neglected. Of American children with the highest test scores in eighth grade, only 29% of those from low-income families ended up going to college, compared with 74% of those from high-income families. Since the better-off can afford to keep their children in higher education and the poor cannot, breaking out of the cycle is hard.

Perhaps Americans put up with this system because they have unrealistic expectations of their chances of success. One study found that 2% of Americans described themselves as currently rich but 31% thought that they would become rich at some stage. In fact only 2-3% of those in the bottom half of the income distribution have a chance of becoming very well off (defined as having an annual income of more than $340,000). Just over half of those earning $75,000 a year think they will become very well off, but experience suggests that only 12-17% will make it.

Health outcomes too are decidedly unequal; the gap between the life expectancy of the top and bottom 10% respectively rose from 2.8 years to 4.5 between 1980 and 2000. That does not meet the definition of a fair society by John Rawls, a 20th-century philosopher, who described it as one in which a new entrant would be happy to be born even though he did not know his social position ahead of time.

However, these inequalities are likely to lessen now. For a start, this decade has so far seen a dismal performance by the stockmarket, which plays a crucial role in creating and maintaining wealth. Real annual returns from American stocks averaged -4.1% in the decade to the end of 2008.

The pendulum swings back

Property prices are already falling sharply, as noted earlier in this special report. Investment bankers are losing their jobs or at least seeing their bonuses cut, and hedge-fund managers are going out of business. As long as the credit crunch continues, it will be more difficult to use borrowed money to boost incomes. And corporate profits, which usually make a handsome contribution to the incomes of the rich, are declining steeply.

Much of this is what you would expect in a recession, and the poor will be suffering along with the rich. But although they may lose their jobs and default on their loans, they will not be troubled by collapsing asset prices because they do not own assets. Edward Wolff of New York University points out that the proportion of American households owning some stocks (including mutual funds and 401k pension plans) went up from 32% in 1983 to 51% in 2001. But only 32% of the population owned more than $10,000-worth of stock, and many middle-class people are only modestly affected by falling asset prices. The richest 10% of the American population owned 85% of all stocks.

Ajay Kapur, the strategist at Mirae Asset Management who coined the term “plutonomy”, identifies six factors that helped to create the phenomenon; the existence of capitalist-friendly governments and tax regimes; the development of financial complexity, innovation and deregulation; the paramount rule of law; globalisation; technology changes; and patent protection. Some of these are already being affected by the recession. Governments have become less friendly towards capitalists and regulations are being tightened. The rule of law is being replaced by what Mr Kapur dubs the rule of man: politicians and central bankers are changing the system on the hoof. “It is hard for investors to know the rules of the game because they keep changing,” he says.

With plutocrats now causing widespread anger, and with public-sector deficits widening, governments will be tempted to target the tax privileges of the wealthy. But how easy will it be to get hold of their money?

Giving it away

Apr 2nd 2009
From The Economist print edition

Will the rich become less charitable?

IN JUNE 2006 the then two richest men on the planet performed a remarkable ceremony. Warren Buffett, an eminent investor, agreed to hand over the bulk of his fortune to the foundation run by Bill Gates, the founder of Microsoft. It was a gesture that recalled the philanthropic heyday of Andrew Carnegie, the late-19th-century steel baron who became famous for funding public libraries.

How typical is such generosity of modern billionaires? Frustratingly, it is very hard to tell. The endowments of American foundations more than doubled between 1996 and 2006, but the increase only just kept pace with the rise in the total wealth of the *Forbes* 400 over that period. There is no evidence that the rich have been getting more, or less, generous.

What does seem to have changed is their attitude towards the way their money is used. They have become much more willing to get directly involved in the projects they fund. Mr Gates, for example, has left Microsoft to take charge of his foundation, including its work in fighting diseases such as malaria and AIDS. This increasingly businesslike approach of the new rich is reflected in an ugly new word, philanthrocapitalism (which is also the title of a book by an *Economist* journalist).

Again, it is hard to say whether Mr Gates's approach is typical. Charitable giving covers a wide range of activities, from fighting poverty in Africa to paying for a local concert hall. Local good deeds often owe as much to vanity as to genuine concern for others.

Will the financial crisis reduce charitable giving? According to the US Foundation Centre, which has figures going back to 1975, giving did not decrease, in real terms, during the recessions of the early 1980s and 1990s. American foundations can be flexible; tax rules require them to pay out 5% of their assets each year, but this can be calculated on a rolling average. In fact, the Gates Foundation says it has increased its payout ratio from 5% to 7% in response to the downturn.

But those measures involve spending money that has already been donated. It seems likely that the pace of new donations will slow down. For example, a big hedge-fund charity, Absolute Return for Kids, is planning a more modest annual dinner this year because the industry has shrunk. The Institute for Philanthropy sees something of a downturn in donations from corporations and from the "mass affluent"—the tier just below the wealthy. There is also some evidence that donors are spending their money closer to home, helping the poor in their own country rather than overseas.

But it is probably too early to tell what the rich will do when they have fully understood the massive hit to their wealth. The Obama administration is also proposing to reduce the tax break for charitable giving. The plutocrats may yet be tightening their purse strings.

Plucking the chickens

Apr 2nd 2009
From The Economist print edition

But taxes have their limits

THE rich are paying more tax; the rich aren't paying enough. Depending on which statistics you use, you can make a convincing case either way.

America's Internal Revenue Service publishes figures showing the proportion of income-tax receipts paid by different segments of the population. Back in 1986 the top 1% of taxpayers were responsible for 25.4% of all income tax paid; by 2005 their share had risen to 38.4%. The IRS also has figures for the top 400 American taxpayers. In 2006 their incomes averaged more than $263m, compared with $214m the year before. On those incomes they paid tax at an average rate of just 17.2%, well down from a peak of 29.9% in 1995; 31 of those 400 paid less than 10% in tax.

These figures are two sides of the same coin. The rich are paying a lot more tax in nominal terms because, as this special report has demonstrated, they have got a lot richer. But the rates of tax they pay have come down. Those on the political right can cite this as evidence that lower tax rates eventually increase tax receipts; those on the left, that the rich have been getting away with lower taxes at a time when median incomes have stagnated.

Governments around the world would like a bigger share of the pie as they seek to narrow deficits and placate angry electorates. One route they have been pursuing is to crack down on tax havens, those boltholes for the world's wealthy. Estimates of the amount held offshore range from $5 trillion to $7 trillion, so there is a strong incentive for governments to bring this money home.

In 2000 the Organisation for Economic Co-operation and Development identified over 40 tax havens; it has since persuaded 35 of them to commit themselves to a set of standards on transparency and information exchange. According to the OECD, some 49 agreements to exchange tax information have been signed since 2000 between countries ranging from Antigua to Sweden.

Countries that will not co-operate are named and shamed. Seven jurisdictions originally refused to make the commitment and were placed on a list of unco-operative tax havens; the blacklist has since shrunk to just three, Andorra, Liechtenstein and Monaco. In March Andorra and Liechtenstein pledged to weaken their secrecy laws. Switzerland, Austria and Luxembourg offerd to share information on savers with other governments on a case-by-case basis.

Individual countries are also taking action. In February UBS agreed to pay a $780m penalty to the American government and to disclose the names of some 250 customers to avoid prosecution over having helped wealthy Americans avoid taxes. The American authorities promptly demanded that the Swiss bank hand over the names of a further 52,000 customers, which would require the bank to break Swiss law. (The Swiss have long made a distinction between tax evasion—not too serious—and tax fraud.) John Whiting of PricewaterhouseCoopers in London says the British authorities have been trying to get information about their own offshore-accountholders in a number of ways, including tapping the databases of high-street banks.

The German government used whistleblower laws to target citizens who had banked in Liechtenstein; some 900 suspects were pursued, including a former chief executive of Deutsche Post. The tiny principality was outraged, but its government fell in February and the new prime minister, Klaus Tschütscher, pledged to work with other countries and to get his country off the "unco-operative" list. A European Union meeting in Berlin in late February called for sanctions against states that do not play ball.

Countries such as Liechtenstein and Monaco are historical accidents, places that might easily have been tidied up by Napoleon or by the Treaty of Versailles after the first world war. They exist on the sufferance of larger states on whom they depend for defence and for transport links. But the EU finds it harder to put pressure on faraway countries.

Even so, with America and the EU both weighing in, there is some doubt about the long-term future of bank-secrecy laws. “The combination of whistleblower legislation and a lot of upset ex-employees in the financial-services industry may mean that in two or three years’ time there will be no such thing as a secret account,” says David Lesperance, a tax adviser. “Already, if you own any US securities, any bank you want to deal with is obliged to report the fact to the US authorities.”

Philip Marcovici of the Zurich office of Baker & McKenzie, a law firm, says wealthy people can now do one of two things; play by the rules of their home country or get out. Staying in their country and breaking the law by hiding assets and income is not an option.

Want to know a secret?

But Mr Marcovici thinks governments are not approaching the issue of undisclosed income strategically. “They attack banks and jurisdictions and that forces them to get defensive. If they admit the problem, that will get them into legal trouble. Banks need to be part of the solution, and scaring wealth-owners into trying to hide the money better and farther is not in anyone’s interest.”

Banks may react by blaming a particular employee for aiding tax evaders when the problem is in fact endemic. Clients are free to leave Liechtenstein and move their money somewhere that is less susceptible to pressure from the European authorities.

One way of trying to deal with the problem of offshore tax evasion is a withholding tax that enables countries to deduct tax automatically and leave it up to the taxpayer to reclaim the money if he can. But this may not work. The EU savings directive, for example, says a withholding tax must be imposed on interest paid to an individual resident of an EU country or through a bank in the EU or an affiliated country. But it is easy to avoid the tax by turning the payment into something other than interest (such as capital gain), set up a company to receive it or have it made through a non-EU bank.

Such loopholes are common. One big controversy in recent years has been the tax treatment of “carried interest” in private-equity funds. This interest gives the fund managers the right to participate in future profits without putting up capital; in effect, it is a performance fee. In both America and Britain it has been taxed as a capital gain rather than as income, substantially lowering the managers’ tax bill. As one private-equity manager admitted, “any commonsense person would say that a highly paid private-equity executive paying less tax than a cleaning lady or other low-paid workers can’t be right.”

Another issue is the status of wealthy foreigners who usually enjoy tax privileges denied to domestic citizens. Voters in the Swiss canton that includes Zurich voted in February to end the practice of offering flat-rate deals for foreigners who choose to live in the area (the vote covered cantonal but not federal taxes). In Britain the political parties got into a brief bidding war over plans to tax the so-called “non-doms”, people deemed to be resident in Britain but not domiciled for tax purposes. The idea was to impose a flat fee in return for ignoring their offshore earnings; previously foreigners were taxed only on such money as they brought into the country.

Soak the rich…

The British authorities are generally agreed to have made a mess of the proposals. According to Caroline Garnham of Lawrence Graham, a law firm, the big problem with the legislation was that the fee proposal was accompanied by 70 pages of anti-avoidance legislation. “Wealthy people don’t want an investigation into their affairs by the British authorities because they don’t know where the information will end up,” she says. The predicted mass exodus of foreigners has not materialised so far, but then the new rules are only just about to kick in. Ms Garnham explains that “people haven’t gone yet because they haven’t had to file tax returns.”

It is a sign of the political times that countries such as Switzerland and Britain, long seen as havens for the wealthy, are changing the rules. As the recession bites, voters are likely to become increasingly

resentful towards those enjoying a free ride at the expense of other taxpayers.

In the long term it may not be politically sustainable to discriminate against the natives by giving special tax deals to foreigners. In Hong Kong and Singapore it makes no difference whether you are a foreigner or a local: you pay tax only on income from domestic sources. Those two countries may be the tax havens of the future.

Illustration by Alex Nabaun

But the tide is not running all one way. Just as some jurisdictions try to close tax loopholes, others will keep them open. In Sweden the authorities dropped a wealth tax in 2007 in part because some rich Swedes had been moving to London. Taiwan agreed to cut its inheritance tax from a maximum of 50% to 10% in part because the wealthy had been moving money to Singapore and Hong Kong. In the Caribbean, St Kitts & Nevis offers citizenship in return for a property purchase of $350,000 plus government fees; citizens are able to enjoy foreign income, capital gains, gifts, wealth and inheritance free of tax.

What makes this tax competition even more acute is the mobility of money in a globalised world. Most developed countries abolished capital controls long ago. The very narrowness of the tax base, as illustrated by the numbers showing how much the top 1% contribute in America, highlights the danger of driving such people away.

In addition, political parties in many countries depend on wealthy individuals. Politicians have had to tread carefully for fear of giving offence to their paymasters.

Such pressures led to cuts in personal income-tax rates between 2002 and 2008 in 33 out of 87 countries surveyed by KPMG International, a firm of accountants, whereas only seven saw increases. The top rate fell from an average of 31.3% to 28.8%.

…but not too much

In Britain the Labour government has abandoned its long-standing pledge not to raise the top rate of income tax and imposed a 45% levy on those earning more than £150,000 a year. In America President Obama’s first budget proposals included an increase in capital-gains tax and a rise in the highest rate of income tax back to levels last seen in the Clinton era. That trend is now likely to be reversed.

It seems unlikely that developed countries will ever go back to the income-tax rates of 90% or more seen in the 1970s, but some of the higher taxes recently introduced will surely stick, for three main reasons. First, most countries face big budget deficits, which makes it tempting to raise taxes to help fill the hole. Governments that ask middle- and working-class voters to shoulder the whole of the burden may quickly lose office.

Second, although in theory it is possible to move between countries to avoid tax, there are lots of practical difficulties. Family ties, business requirements and personal preferences are likely to persuade many people to pay somewhat higher taxes rather than uproot their lives. The recent crackdown on tax havens may also deter many investors from moving their capital.

Third, there is the issue of security. The British government pointedly failed to help accountholders with the Guernsey branch of Landsbanki, a failed Icelandic bank. The Channel island, long seen as a tax haven for British investors, does not have a deposit-protection scheme.

“The tax authorities are trying to make it steadily more difficult to avoid tax,” says Mr Whiting. The effect is to push evaders to the fringes of the system, where they may be more at threat from fraudsters than from the taxman. Rich people may feel it is better to pay some of their money in tax than to risk losing it all in a jurisdiction with lax rules.

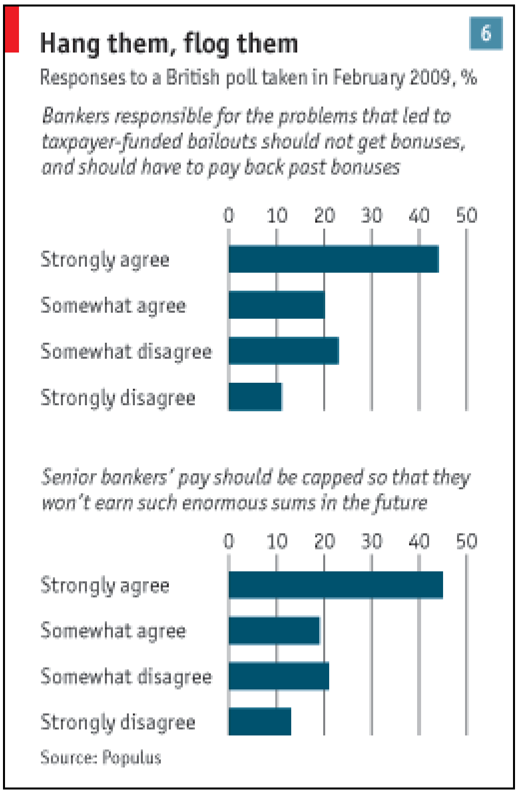
Paying the bill

Apr 2nd 2009
From The Economist print edition

The rich will become a little poorer. That may be no bad thing, but beware a backlash

SOCIETIES have often distinguished between the deserving poor (afflicted by sickness or disability) and the undeserving sort (the feckless and workshy). These days they also seem to differentiate between the deserving and the undeserving rich.

Ordinary people do not seem to mind that sports stars or entertainers make millions; they also seem to respect genuine entrepreneurs who have built businesses that are obviously useful. But they have little time for bankers, hedge-fund managers and other financiers. Society as a whole may benefit from the efficient allocation of capital or the increased liquidity that financial markets provide, but the public cannot easily see the gains.



A Populus poll in February, for example, found that 64% of Britons thought that the staff of banks part-owned by the government should not get any bonuses at all; the same proportion thought that senior bankers who made mistakes should repay past bonuses. A remarkable 82% thought that pay for senior bank staff should be capped (see chart 6).

As governments are forced to step in to save other sectors of the economy, it seems plausible that the public will take a similar attitude towards executives of other failing businesses. The intellectual argument that high pay is needed to create incentives probably rings hollow with most people at the moment. What is clear to the public, though, is that bankers and businessmen earn fortunes in good times and shout for help from the taxpayer in bad times.

We've been here before

Revolts against the power of the rich have been a regular feature of American history, going all the way back to Thomas Jefferson. It was a Republican president, Theodore Roosevelt, who said that "every man holds his property subject to the general right of the community to regulate its use to whatever degree the public welfare may require it." His cousin, the Democrat Franklin Roosevelt, argued that "the transmission from generation to generation of vast fortunes by will, inheritance or gift is not consistent with the ideals and sentiments of the American people."

The era of progressivism embodied by Theodore Roosevelt led to the introduction of a federal income tax and the establishment of the Federal Reserve, which Woodrow Wilson saw as a counterweight to the power of financiers such as JPMorgan. Franklin Roosevelt eventually brought in a wartime top income-tax rate of 91%. Now Barack Obama has suggested raising the tax rates on high earners and closing loopholes such as the carried-interest privilege enjoyed by private-equity managers.

Such tax changes may suit the public mood. The danger is that popular anger, once released, can fasten on targets beyond the rich; immigrants, say, or foreigners generally. The 1930s Depression led to fascism in Germany and the second world war.

Even if such apocalypses are avoided, the anti-rich backlash can go too far. In the middle of a deep recession it is easy to forget that the previous 15 years had seen steady economic growth in the developed world, a remarkable growth surge in many emerging markets, low inflation and rapid

technological development.

The trick will be to change regulation to reduce the risk of running up too much debt again but still allow new industries to be created and financed. If entrepreneurs can come up with cheap solar technology, say, or develop drugs to cure cancer, they will deserve all the money they can get.

The world is emerging from a long period of financial speculation. Some people got rich because they were talented, others because they were lucky. That luck ran out in 2007. The ranks of the rich are set to be thinned in coming years—but perhaps the wealth of those that remain will be more soundly based.

Sources and acknowledgments

Apr 2nd 2009
From The Economist print edition

Apart from the people quoted in this report, the author would also like to thank the following for their help: Walter Berchthold, Olivier de Givenchy, Marten Hoekstra, Neil Honebon, Axel Hoppenot, Mark Kibblewhite, Andrew Milligan, Helena Newman, Xavier Rugeroni, Deborah Sterescu, Gilles Tonelli and Chris Watling.

Sources

"Controversies about the rise of American inequality: a survey", by Robert Gordon and Ian Dew-Becker, Working Paper 13982, National Bureau of Economic Research, April 2008

"Where did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income", by Robert J. Gordon and Ian Dew-Becker, Working Paper 11842, National Bureau of Economic Research, December 2005

"Is This a Great Country? Upward Mobility and the Chance for Riches in Contemporary America", by Thomas DiPrete, Columbia University, November 2005

"The Promises and Pitfalls of the New Economy", in "The State of Working America" by the Economic Policy Institute

"Globalisation, Inequality and the Rich Countries of the G-20; Evidence from the Luxembourg Income Study", by Timothy Smeeding, SPRC Discussion Paper No 122, December 2002

"The Great Compression: The Wage Structure in the United States at mid-century", by Claudia Goldin and Robert Margo, Working Paper 3817, National Bureau of Economic Research, August 1991

"Inequality, Growth and Investment", by Robert Barro, Working Paper 7038, National Bureau of Economic Research, March 1999

"A Rolling Tide: Changes in the Distribution of Wealth in the US, 1989-2001", by Arthur Kennickell, Federal Reserve Board, September 2003

"Racing Away? Income Inequality and the Evolution of High Incomes", by Mike Brewer, Luke Sibieta and Liam Wren-Lewis, IFS Briefing Note 76, January 2008

"The Evolution of Top Incomes: A Historic and International Perspective", by Thomas Piketty and Emmanuel Saez, 2006

"Richistan: A Journey through the 21st Century Wealth Boom and the Lives of the New Rich", by Robert Frank, Piatkus Books, 2007

"Super Rich: The Rise of Inequality in Britain and the United States", by George Irvin, Polity, 2008

Offer to readers

Apr 2nd 2009
From The Economist print edition

Buy a PDF of this complete special report, including all graphics, for saving or one-click printing.

The Economist can supply standard or customised reprints of special reports. For more information and to place an order online, please visit our Rights and Syndication website.

America's car industry

Time for a new driver

Apr 2nd 2009
From The Economist print edition

General Motors gets a new boss, but Barack Obama is really in control

Bloomberg

IF AMERICA'S two beleaguered carmakers, General Motors (GM) and Chrysler, had harboured the hope that Barack Obama would prove a soft touch, any such illusion has been robustly dispelled. When the news leaked on March 29th that Rick Wagoner, GM's chief executive for nine years, had been told to step down by the president's auto task-force in favour of his number two, Fritz Henderson (pictured), there was little doubt that more unpleasant medicine was on the way. So it proved.

The next day the task-force gave its analysis of the "viability plans" the two firms had submitted in February as a condition of the $17.4 billion emergency-loan package agreed on December 31st ($13.4 billion for GM, $4 billion for the much smaller Chrysler). Its verdict on both plans was damning; its threat that bankruptcy, albeit of a "quick and surgical kind", could still be the best option, was unambiguous.

Although GM was given some credit for restructuring its business in recent years, the task-force concluded that progress had been far too slow, and that something much more thorough than GM's management and key stakeholders seemed willing to contemplate was needed. Furthermore, the assumptions on which GM was basing its plans were a good deal too rosy and left uncomfortably little margin for error.

The task-force identified six areas where it found GM to be over-optimistic or in denial: domestic market share, which it expects to contract by only 0.3 percentage points a year after 30 years of falling by 0.7 points; pricing in a collapsing market which still doubts the quality of GM's products; the drag of underperforming dealers; the consequences of the failure of GM's European arm to secure outside investment or government support; a weakening product mix as consumer tastes and tighter fuel-economy rules eat into sales of high-margin trucks and sport-utility vehicles; and legacy health-care and pension liabilities that will reach $6 billion a year by 2013, forcing GM to maximise volume rather than return on investment.

But GM can take one quite substantial crumb of comfort from this otherwise bleak assessment: Mr Obama's team reckons that if it can shove the company, its unions and its bondholders into taking more drastic and painful action, a healthy business could yet emerge. GM has started making some good, desirable cars in efficient, flexible factories. Critically, GM also has the scale, technology and reach that a capital-intensive, highly competitive global industry demands.

None of this, unfortunately, applies to Chrysler. On just about every count, the task-force sees Chrysler as a basket-case. Saddled with out-of-date factories, over-reliance on the North American market and unfashionable trucks, a poor reputation for quality, a dearth of new models in the pipeline and insufficient resources to fund future power-train development, Chrysler is too weak and too small to survive on its own.

Chrysler's only hope, Mr Obama said on March 30th, is to consummate the deal it has been discussing since January with Fiat. The Italian firm would supply it with "cutting-edge technology" in the form of fuel-efficient engines, small-car platforms and factory automation. In return, Fiat had expected a 35% stake in Chrysler, a strong base from which to buy the rest of the company should it so wish, as well as a manufacturing and distribution base in America. In negotiations held in March between Steven Rattner, the investment banker who leads the task-force, and Sergio Marchionne, Fiat's boss, Fiat agreed to scale back its initial stake to 20% and not to increase it beyond 49% until Chrysler had repaid American taxpayers in full.

Chrysler now has until the end of April to get the deal done. Meanwhile the government will continue to supply it with working capital. Mr Obama says he will "consider" lending the firm a further $6 billion if it can construct a credible plan with Fiat. But can it? Mr Marchionne is adamant that Fiat will not put any of its own much-needed cash at risk, and the Fiat team that has been carrying out due diligence on Chrysler thinks it will be two years before the American firm will feel real benefit from the partnership. Given that Chrysler has spent most, if not all, of the $4 billion it received in January, it is hard to see how $6 billion will take it through to 2011.

The government says that if Chrysler is to survive alongside Fiat it will require "at a minimum… extinguishing the vast majority of Chrysler's outstanding secured debt [about $9 billion] and all its unsecured debt and equity." Cerberus Capital Management, the private-equity firm that acquired an 80% stake in Chrysler in August 2007, seems resigned to surrendering its equity, and the banks that hold unsecured debt are also in a weak position. But the senior debt holders may decide that they will fare better if Chrysler files for bankruptcy and they can make a grab for whatever sellable assets are left.

The outlines of GM's future are not much clearer, but at least it seems to have one. "We cannot, we must not, and we will not let our auto industry simply vanish," Mr Obama said this week. That does not, however, mean that GM will necessarily avoid bankruptcy, as Mr Henderson acknowledged. In a marked change of tone from the old regime, of which he was a part, Mr Henderson said he was prepared to do whatever was necessary to reorganise GM—including making a trip to the bankruptcy court if agreements could not be reached with bondholders and the United Auto Workers union to slash more than $50 billion of liabilities.

Mr Obama has given Mr Henderson 60 days (and sufficient working capital) to bang heads together and drive through other changes. Above all, the task-force will want to see evidence that GM can repair its balance-sheet and become capable of generating positive free cashflow in a car market somewhat bigger than today's, but smaller than in the past.

There is, however, a growing belief that the best way to achieve that may be a "quick rinse" bankruptcy reorganisation which separates a new, lean and mean GM from an old GM that holds legacy health-care obligations, dud brands and unwanted factories. Supposedly, the former would swiftly fly free, while the latter would remain in bankruptcy and be slowly wound down. In practice, nothing is likely to be that neat. The only certainty is that even though GM has a new boss, the government is really in control.

Carmaking in France

Mover and shaker

Apr 2nd 2009
From The Economist print edition

Christian Streiff makes another exit

IF GENERAL MOTORS' Rick Wagoner was fired for not being confrontational enough, the other car boss to lose his job last weekend, Christian Streiff, was almost certainly ousted from PSA Peugeot Citroën for precisely the opposite reason.

Mr Streiff called the decision by the board of Europe's second-biggest carmaker to get rid of him without warning "incomprehensible". In some ways it was. During his two-and-a-bit years running the family-controlled firm, Mr Streiff cut costs, sped up development of new cars and improved quality. On his watch Citroën was restored from being a cheap and cheerful discount brand to something like its former glory.

Even so, there were problems. Mr Streiff has a habit of trying to shake things up just a bit more than the boards he serves find tolerable. That bullishness led to his removal from Saint-Gobain in 2005, when on the verge of becoming the building-materials firm's chief executive, and his abrupt departure from Airbus in 2006 after only 100 days at the controls.

At PSA, it looked at first as if Mr Streiff had learnt to be more diplomatic. But when some of his plans met internal opposition, he went ahead without checking that he had the support of the Peugeot family, which owns 45% of the voting stock. His authority may also have been weakened by health problems last year. Mr Streiff insists his health is now fine, but critics suggested he was no longer at the top of his game when the industry's crisis required nothing less.

Mr Streiff courted further controversy when, two days after negotiating a €3 billion ($3.9 billion) loan from the French government in February, he announced 11,000 job losses on top of the 18,000 he had already culled. President Nicolas Sarkozy's displeasure would not have gone unnoticed by Thierry Peugeot, PSA's chairman. Mr Streiff will be succeeded by Philippe Varin, former chief executive of Corus, a steelmaker, and a notably smooth operator.

Computing

Clash of the clouds

Apr 2nd 2009
From The Economist print edition

A familiar-sounding industry spat breaks out over standards

Illustration by David Simonds

CLOUD computing may be the next big thing, but its politics are as old as the mainframe. Geeks from the early years of the information-technology (IT) industry would have had no difficulty deconstructing a quarrel that has broken out among IT's modern giants. At issue is an "Open Cloud Manifesto", which was published on March 30th.

Even before that date, accusations were flying around online. What caused the controversy was not so much the content, which is vague enough for almost everyone to agree with it. The "manifesto" essentially calls for computing firms not to fall back on bad old habits by trying to lock in customers as computing becomes a utility, generated somewhere on the network ("in the cloud") and supplied as a service. Since there will be many different computing clouds, the manifesto points out, customers should be able to move their data and applications easily from one to another, and "open" standards, not controlled by one company, should be used whenever possible.

Although most companies would agree on the need for openness in theory, there is room for disagreement in practice about the timing. Cloud computing is in its early days. Many technical problems have yet to be solved, and the industry has still not even settled on a definition of cloud computing. Agreeing on principles for openness and perhaps even standards at this stage would benefit some firms and hurt others. It would create opportunities for latecomers and for new start-ups, and make life easier for firms who help companies stitch together their IT systems. But it would also rein in those firms that have already built cloud-computing businesses, often using proprietary technologies developed to solve particular problems. Arguably, nailing everything down too early may also hamper innovation.

It is hardly surprising that IBM is the main force behind the manifesto. The technology giant has long been a champion of open standards—not least, many say, because it makes most of its money from its huge services arm. Among the nearly 100 supporting firms are many start-ups, including Cast Iron, Engine Yard and RightScale. Others in favour include Cisco, EMC and SAP. These heavyweights support openness because widespread adoption of cloud computing would expand the market for their products.

Just as predictably, the leaders in cloud computing are absent from the list of supporters: Amazon, an online retailer that has successfully branched out into computing services; Google, which is not only a huge cloud unto itself but has built a cloud-computing platform for use by others; Salesforce.com, the biggest provider of software-as-a-service; and Microsoft. Indeed, it was an executive at the world's biggest software firm, Steven Martin, who first leaked the manifesto, complaining that it had been drawn up in secret. "It appears to us that one company, or just a few companies, would prefer to control the evolution of cloud computing," he wrote in a blog.

Things have now calmed down a bit. Supporters and opponents of the manifesto met at a conference in New York this week and agreed "on a shared goal to promote the use and awareness of open and interoperable cloud computing", as one participant put it. But if history is any guide the controversy is sure to flare up again once cloud computing really takes off. There could even be an all-out standards war. But the row has at least ensured that the question of openness in the cloud has received a lot of attention, observes Bob Sutor, IBM's point man for standards: "People have been put on notice that they can get locked into a cloud."

Online gaming in China

Intangible value

Apr 2nd 2009 | HONG KONG
From The Economist print edition

Changyou is making a fortune selling items in a virtual world

PERHAPS it should not be a surprise. In the midst of a global capital shortage, the first company to list this year on New York's NASDAQ exchange not only needs no money; its source of profit is receiving cash for items that do not exist.

Changyou is a three-year-old online-gaming business being spun out of Sohu, China's second-largest internet portal. The deal was due to be priced on April 2nd, as *The Economist* went to press, in a nostalgic reminder of what the stockmarket used to look like. At the top of the expected price range Changyou will be valued at about $820m, after a special distribution of $100m to its parent. The opening price may be higher still, given strong demand.

The enthusiasm for Changyou is understandable. Unlike much of the internet, where services have to be free in order to be popular, Changyou makes money. In short order, revenues have risen to $202m and profits to $108m. That is because Changyou is one of several Chinese firms to have stumbled upon a remarkable niche that has grown into a multibillion-dollar industry. Video-gaming developed in America, Europe and Japan largely around console hardware and its associated packaged software. China initially banned games consoles, and by diligently failing to enforce intellectual-property laws, it wrecked the economics of the console business by allowing pirated games to be sold for pennies, thus undermining any incentive to market them.

China took a similarly firm line with other forms of entertainment, allowing only limited local production of films and television programmes, and sharply restricting imports (legal ones, at least). In this desert, the internet has flourished, at first as a place for pirated foreign films and shows, but over time for online multiplayer games, too. Companies created a business model based on allowing access from any computer—customers pay as little as 25 cents an hour at internet cafés—but where the computational heavy-lifting is done on their own servers. These provide the background environment and connect the players—in Changyou's case, as many as 738,000 at a time.

Popular games in China typically feature elves, dwarves or characters that predate the past century of political turmoil. Changyou's most popular offering, "Tian Long Ba Bu", began as a book about the travails of a prince, a monk and a beggar, with lots of martial arts. At first Changyou charged subscription fees to play, but abandoned them because multiplayer games are generally more fun with more players. Like most other firms, it now provides free access to its games, collecting revenue from the 10% or so of players who are prepared to pay for in-game extras such as weapons, medicine and shields, says Benjamin Joffe, chief executive of Plus Eight Star, a technology consultancy in Beijing.

AP

In a world of their own

These extras typically cost a few cents, but some are much dearer: Changyou sells a virtual gem, which can be used to enhance a virtual sword, for $180. Demand for these virtual goods depends on their cost, properties and availability, exactly as in the real world, says Mr Joffe. Clever gaming companies constantly monitor demand and tweak supply to maintain their revenues, in a sense fine-tuning their own virtual economies.

There are risks to Changyou's business, most notably from competition. Growth recently slowed abruptly. There are more than half a dozen publicly listed Chinese gaming companies, and over 100 more with viable products, according to BDA, a consultancy based in Beijing. Hundreds, if not thousands, of other companies are eyeing this promising market.

Still, the battlefield is not as dangerous as it might appear. Before 2006 South Korean and American companies dominated the market, and the world is full of clever programmers, all of whom are theoretically linked by the internet. But as was the case in console-based gaming, the Chinese government has intervened, says Ning Liu, an analyst at BDA. Licensing of new versions of foreign games has been delayed, and local firms have gradually learnt to develop their own products. In the Chinese business environment, even the virtual world has real walls.

Consumer psychology

From buy, buy to bye-bye

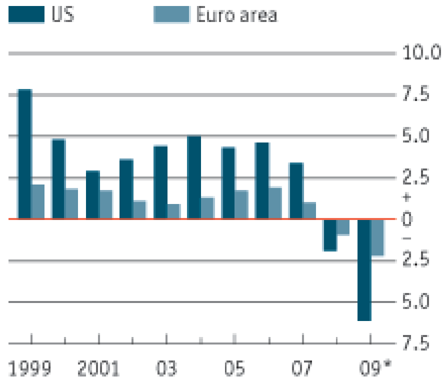
Apr 2nd 2009 | NEW YORK AND SAN FRANCISCO
From The Economist print edition

The recession will have a lasting impact on the way people shop

“WANT IT!” screamed the words plastered on the walls, counters and shopping bags in the flagship emporium of Saks, a big American retailer, on Fifth Avenue in New York. The same exhortation was emblazoned in huge letters on a giant red and white ball that revolved slowly in the middle of the main sales floor. Saks’s spring marketing campaign, which came to an end on April 1st, made its brazen appeal to greed in a bid to drum up sales in a dire market. But the exclamation mark in its “Want It!” tagline should perhaps have been a question mark instead.

Asked whether they want more stuff, consumers in rich countries have responded with an emphatic “No”. The breathtaking speed with which retail sales have plummeted in both America and Europe (see chart) has caught retailers and manufacturers by surprise. In response, companies have tried desperately to prop up revenues using a variety of promotions, advertising and other marketing ploys, often to no avail.

Falling off the shelf
Retail sales, % change on previous year, volume



Sources: US Census Bureau; Eurostat
*Latest month

But as they battle with these immediate problems, marketers are also pondering what longer-term changes in consumer behaviour have been triggered by the recession. It is tempting to conclude that, once economies rebound, customers will start spending again as they did before. Yet there are good reasons to think that what promises to be the worst downturn since the Depression will spark profound shifts in shoppers’ psychology.

The biggest changes will take place in America and parts of Europe, where housing and stockmarket bubbles have imploded and unemployment has soared. As well as seeing their incomes fall as employers cut wages and jobs, households have also seen the value of their homes and retirement savings shrink dramatically. Although the threat to wages will fade as growth picks up, the damage done to housing and other assets will linger.

This has already led to a swift tightening of purse strings by shoppers and a wave of discounting by companies. Inmar, an American firm that processes discount coupons, says that redemptions in America were 17% higher in the first quarter of 2009 than in the same period last year, as consumers hunted for bargains. Many companies have launched lower-priced products in order to avoid losing customers as they trade down. Danone, a French food group, has created a line of low-cost yogurts in Europe, called “€co Packs”, that come in smaller tubs and fewer flavours than its standard products.

The trend towards thrift will not disappear when the economy picks up. For one thing, those banks left standing after the bust will be far more parsimonious with consumer credit. For another, many people will still be intent on rebuilding their nest-eggs, which is reflected in sharply rising rates of saving. Sociologists also detect a distinct change in people’s behaviour. Until the downturn, folk had come to assume that “affluence” was the norm, even if they had to go deeply into debt to pay for gadgets and baubles. Now many people no longer seem consumed by the desire to consume; instead, they are planning to live within their means, and there has been a backlash against bling.

So for years to come, many more households will be firmly focused on saving, splashing out only occasionally on a big-ticket item. Some firms are already trying to capitalise on this new mood. Sears, another American retailer, recently revived a savings plan it used many years ago, known as the “Layaway programme”, under which a consumer can make a down payment on an item that is then held for him for a fixed period while he saves the rest of the cash needed to buy it.

A second shift in consumer psychology has been prompted by fallout from the global banking crisis and

the furore over huge bonuses paid by firms rescued with public money; by a wave of financial scandals, such as the Madoff affair in America; and by multibillion-dollar bail-outs of carmakers in many countries. All this seems to be denting trust in business more generally. The Boston Consulting Group recently completed a global survey of consumer sentiment involving 15,000 consumers. The results, to be published this month, show that over half of respondents from America and Europe say the crisis has intensified their distrust of big business.

Past downturns have also stoked anti-business feeling, which dissipated as growth returned. But the sheer scale of the failings that have come to light recently mean that suspicion and wariness will not vanish so easily this time around. In response, firms will need to be even more transparent in their dealings with customers, who will punish them severely if they fail to keep their promises. Bain, another consulting firm, says it has seen several firms appoint executives recently with a specific brief to ensure that price adjustments and service cuts do not damage loyal customers' experience of brands.

Companies will also need to show they empathise with consumers' new concerns. "There will need to be a move from passion to compassion in marketing," reckons John Gerzema of Young & Rubicam, a marketing-services firm. Hyundai, a South Korean carmaker, has taken the hint. In January it said that for a 12-month period it would allow car buyers to return vehicles without incurring a penalty if they lose their jobs. On March 31st Ford and General Motors followed Hyundai's example, saying they would make payments on car loans and leases for a limited period on behalf of buyers who are laid off.

Both the shift towards greater thrift and greater scepticism about brands will influence other consumer trends, too. Interest in things such as green products and healthy foods will continue to grow in a post-crisis world, but customers will be less willing to pay a premium for them, and will demand more value for money when they do.

The downturn will also accelerate the use of social media, such as blogs and social-networking sites, by consumers looking for intelligence on firms and their products. As trust in brands is eroded, people will place more value on recommendations from friends. Social media make it harder for brands to pull the wool over consumers' eyes, but they also offer canny companies a powerful new channel through which to promote their wares and test new products and pricing strategies.

Marketers ignore the messages that emanate from these groups at their peril. For one thing is clear: this recession has triggered a wholesale reappraisal by shoppers of the value that their habitual brands deliver. The winners will be those that adapt intelligently to the new reality. The losers will be those who think they can win simply by telling consumers to "Want It!"

Face value

Ticket to ride

Apr 2nd 2009
From The Economist print edition

The man who took the bus from Aberdeen to America

UPPA Photoshot

BRITAIN does a line in companies that take a hammering for perceived failings at home but are more respected abroad. Rolls-Royce, for instance, had to put up with investors dismissing it as a fragile maker of jet engines while it was in fact transforming itself into a global engineering, energy and services group. BAE Systems lost face at home selling out of Airbus, but used the proceeds to bulk up in America—the largest single market for defence systems. And for some years BT was held up as the model of a visionary telecoms company by foreign observers, even as its domestic customers grumbled about poor service and endless “you are on hold” music. Sir Moir Lockhead is chief executive of FirstGroup, yet another British firm that is derided at home but is in fact doing rather well abroad. Under his leadership First, which started out as a regional British bus operator, moved into trains and then transformed itself into one of the world’s biggest transport companies by taking control of two American icons—yellow school buses and Greyhound intercity coaches.

Back home, First is best known as Britain’s largest train operator, lambasted for every late arrival in Reading, Bath or Bristol (its biggest route) rather than being lauded for increasing profits in the six months to September last year, despite the credit crunch and a collapsing economy. Sour commuters call its First Great Western service from London “Worst Great Western”. Sir Moir wearily insists that many of the problems stem from under-investment by Network Rail, which owns the tracks, and points to his own firm’s investment in new rolling stock. First’s four regional franchises now account for about a quarter of rail travel in Britain. It also runs a fifth of all local bus services.

Despite his Scottish-sounding name, Sir Moir is a big, bluff character from the rugged north-east of England. He made his name even farther north, in the Scottish city of Aberdeen, Britain’s oil capital. Texan boots and cowboy hats are a frequent sight at the local airport, but few take the Texan theme as far as Sir Moir: he lives on a ranch in the rolling countryside near the queen’s Scottish seat of Balmoral, breeding Aberdeen Angus cattle. Sir Moir was the general manager of Grampian Regional Transport—in effect, Aberdeen’s municipal bus company—when it was privatised by Margaret Thatcher in the mid-1980s. Shortly afterwards he led a management buy-out, after which First emerged as one of Britain’s two leading private bus firms. The other is Stagecoach which, like First, went into railways, buying half of Sir Richard Branson’s Virgin Rail. Both companies also moved into the American market.

Sir Moir had considered expanding into neighbouring European countries such as France and Germany, but found their markets too closed and tightly regulated. So he headed for America instead, persuading Ryder Transportation to sell its school-bus division in 1999. This gave First a toehold in a huge market,

worth about $14 billion, in which 470,000 yellow buses carry 24m schoolchildren every weekday. In February 2007 Sir Moir agreed the takeover of America's Laidlaw group, making First the largest operator of school buses in the United States and Canada and giving it control of the Greyhound coach network, which carries 25m passengers a year. The deal, funded with $2.25 billion of debt, was sealed in October 2007 just as the credit crunch set in. First's shares have since been clobbered, falling by 68% since January 2008, compared with a 40% drop in the main London stockmarket index. Investors worried that First had taken on too much debt and faced high fuel costs.

But fuel prices have fallen from their peak last year, and Sir Moir has refinanced all but $300m of the bridging loans associated with the Laidlaw deal with a mixture of longer-term debt, new equity and a bond issue. The group had sales of £2.8 billion ($5.1 billion) in the six months to the end of September, 57% more than a year before. Its half-year operating profit was £181m, up by 76%. On March 19th First's shares jumped when it predicted solid results for the second half of the financial year, due in mid-May, thanks to a £200m cost-cutting drive and rising profits from Greyhound. Analysts expect an operating profit of around £500m, split equally between Britain and America.

The profits on the bus go up and down

To begin with Sir Moir was not sure what to do with the famous but rather down-at-heel Greyhound brand. He bought Laidlaw primarily for its yellow-bus operation, which has good growth prospects as more local authorities choose to outsource school buses. There were rumours that Greyhound would be sold. But First decided to hang on to it and improve its performance. Worries about Greyhound knocked First's share price in January, even though it accounts for only a tenth of the group's profits. First has invested in improving Greyhound's poor service and punctuality, and Greyhound benefited during 2008 as passengers traded down from planes to coaches. But demand has fallen as the economy has weakened further, prompting First to trim services and cut 1,100 jobs. The company says cashflow and profits are now improving, despite the decline in ticket revenues.

No business can call itself recession-proof when things get as bad as they are now. But running public transport and municipal vehicles is about as sheltered as you can get: Sir Moir points out that about half of First's revenues come from the public sector on both sides of the Atlantic. In Britain, the government provides financial support to rail companies as their revenues fall in a recession. In America, FirstGroup runs city buses and airport shuttles as well as school buses, and its services arm provides logistical support to the navy and air force, and maintains vehicles for government agencies, the police and fire departments. The desire to cut costs is likely to lead to more such outsourcing, rather than less. For Sir Moir it is a long way from running buses in Aberdeen, but it is not a bad place to be at all.

The semiconductor industry

Under new management

Apr 2nd 2009 | DRESDEN
From The Economist print edition

Chipmakers were suffering even before the global economic downturn. Recession is heightening the pain and highlighting changes in structure and ownership

AFP

MOST tourists come to Dresden to view the city's architectural wonders. Beautifully rebuilt, the Frauenkirche (Church of Our Lady), for instance, reveals no hint that its huge cupola once crumbled after a rain of British bombs. But the capital of the German state of Saxony also has more contemporary attractions—at least for technically inclined travellers. It is the hub of one of Europe's biggest technology clusters. Silicon Saxony, as the region has come to be called, boasts 1,500 high-tech firms employing 43,000 people, most of them in the semiconductor industry.

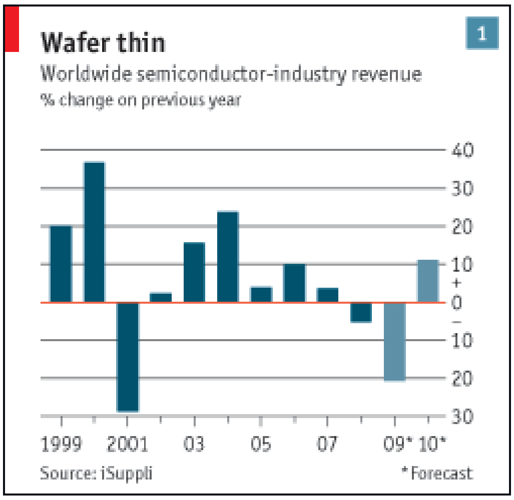
Yet industrial tourists had better hurry. Recently Silicon Saxony has taken some hits that have weakened its foundations. On April 1st Qimonda, a maker of memory chips and the cluster's largest employer, mothballed its factory, having been forced into insolvency earlier this year. Its last hope is to be bought by an outside investor lured by money from the Saxon government. Inspur, a Chinese computer-maker, is among those expressing interest in Qimonda, which has developed some cutting-edge technology.

At Dresden's other big "fab", as chip-fabrication plants are called, is an indicator of another change that may prove just as damaging. There is a new logo at the entrance: visitors are no longer welcomed to AMD but to Globalfoundries. AMD, a maker of microprocessors for personal computers (PCs), decided last year to spin off its fabs into a separate company and to sell a majority stake to investment funds controlled by the government of Abu Dhabi. A good deal of production, some fret, may eventually move from Dresden to the Gulf.

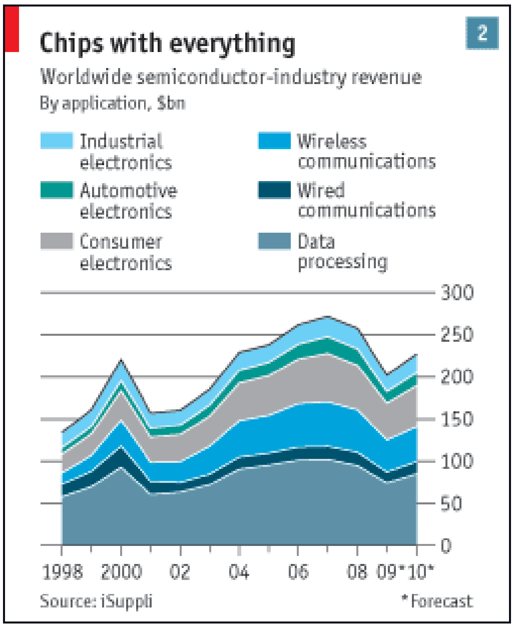
The likely death of Qimonda and the birth of Globalfoundries have turned Silicon Saxony into an industrial showcase of a very different kind. It is a visible token of how hard recession around the world has hit the semiconductor industry, which had already been weakened by one of its periodic downturns. Just as important, it demonstrates the longer-term upheavals in the industry. The semiconductor business is becoming less vertically integrated and more concentrated. And its centre of gravity is shifting eastwards.

Despite a few signs that the worst may be over—Asian chipmakers' share prices soared recently after shortages were predicted—the industry is still in the midst of the longest slump in its 50-year history. If market researchers are right, it will shrink again in 2009 before resuming growth in 2010. iSuppli, one such forecaster, thinks that revenues will fall by more than 20% this year, to $205 billion (see chart 1). Other observers have been making similarly gloomy predictions.

To understand why the semiconductor industry has been so pummelled, think of integrated circuits (ie, chips) not as tiny pieces of silicon engraved with millions of transistors, but as an essential resource. Before long every man-made object will come with at least one embedded microchip (see chart 2). Jerry Sanders, AMD's founder, once called chips "the crude oil of industry". This seems apt: integrated circuits have become the grease of the information economy. The flip side is that chipmakers have come to depend increasingly on the health of the rest of the economy.



The chip cycle



However, the industry's own economics are also to blame. Even without the world's wider troubles, these would have caused problems. In explaining how, Dan Hutcheson, chief executive of VLSI Research, a consultancy, likens semiconductor manufacturing to a different industry: farming. Investment decisions have to be made long before products can be sold. Chip farmers have to spend billions and wait years before they can start etching circuits onto "wafers", those thin disks of semiconductor material, the size of pizzas, which are sliced into hundreds of chips at the end of the production process.

This goes a long way towards explaining why chipmakers, like farmers, have a tendency to oversupply the market, particularly if they sell memory chips, an undifferentiated product (like winter wheat). Even if prices fall below costs, they have an interest in keeping their fabs humming, in order not to lose their heavy upfront investment and to recover the variable costs. What is more, they are caught on a "technology treadmill", in the words of Mr Hutcheson. Competition forces them always to employ the latest technology, which both increases output and puts pressure on prices.

Finally, just as in agriculture, governments further fuel this innate tendency to oversupply. In prestige, national security, industrial policy or just a desire to create jobs, politicians have always found a reason to support their semiconductor industries, mostly with cash. Silicon Saxony, for instance, has received more than €1.5 billion (nearly $2 billion at today's exchange rate) from the state of Saxony alone, much of it to coax AMD into investing.

Asian governments have been the most active. Thanks to Taiwan's industrial policy, more than half of the world's chips are now made there. Support from the South Korean government made Samsung and Hynix the world's biggest makers of memory chips; they supply about 50% of this segment. China seems intent on turning its semiconductor companies into market leaders at almost any price, above all Semiconductor Manufacturing International Corporation, or SMIC. All this explains why of the 40 fabs under construction in 2007, 35 were in Asia, three in America and only two in Europe.

Not surprisingly, at times supply far outstrips demand. From 2002 until last year Asian makers of memory chips, especially, invested as if capital were free—which explains why everybody is now bleeding money. In July 2007 the price of a DRAM (dynamic random access memory) chip with a capacity of 512 megabits was more than $2. In early April it was about 50 cents. Smaller makers cannot cope. Qimonda, for instance, piled up losses of about €1.5 billion between October 2007 and June 2008. Its revenues were only €1.3 billion.

Given the scale of the losses and the screaming from other industries, governments look less inclined to help this time. Even Taiwan is having second thoughts about an ambitious plan to save its memory-chip

industry, announced only last month. The idea is to merge and bail out the country's six makers of memory chips, which have lost $12.5 billion in the past two years and accumulated $11 billion in debts.

Even if Taiwan were to let these firms fail, which is highly unlikely, supply would still exceed demand, according to iSuppli. Global sales of memory chips will not start growing again before next year. And growth will not reattain its 2006 rate before 2015.

Whatever happens to Qimonda and its Taiwanese rivals, the current crisis is sure to speed up two seemingly contradictory long-term trends in the industry. It is consolidating, in that the manufacture of chips is becoming concentrated among fewer companies. At the same time, it is splitting up, in that more companies are specialising in design, and contracting out or quitting the making of chips. Both developments are mainly the consequence of what has come to be called "Moore's Second Law", an economic counterpart to a better known observation by Gordon Moore, one of the founders of Intel, the world's biggest chipmaker by revenue.

The original Moore's Law is usually summarised thus: the number of transistors on a chip doubles every 18 months. In fact Mr Moore first predicted this would happen every year and later changed his forecast to every two years; the average has become his law. Mr Hutcheson points out that Mr Moore made more than a purely technical prediction. He also stated that the cost of an integrated circuit would stay the same, a halving of the cost per transistor with every doubling of the number.

This has turned out to be essentially correct, but progress has come at a high price. The ever more sophisticated equipment required to make semiconductors has been getting dearer with every iteration of Moore's Law. The most advanced chips are built using 32-nanometre technology, meaning that transistors are now so tiny that more than 4m can fit on this full stop. Lithographic tools for transferring Lilliputian circuitry onto a wafer cost up to $50m a pop. To reach the economies of scale needed to make such investments pay, chipmakers must build bigger fabs.

Rising fixed costs give rise to Moore's Second Law: as the cost of transistors comes down, the cost of fabs goes up, albeit not at quite the same rate. In 1966 a new fab cost $14m. By 1995 the price had risen to $1.5 billion. Today, says Intel, the cost of a leading-edge fab exceeds $6 billion, including all the preparatory work. And the Taiwanese Semiconductor Manufacturing Company (TSMC) has built two "GigaFabs" for between $8 billion and $10 billion each, which would buy you four nuclear power stations. The output of such monsters depends on the mix of products, but they each could easily churn out 3 billion chips a year.

These ever-increasing costs and the need for specialisation have caused the industry to splinter, says Derek Lidow, iSuppli's chief executive. Originally, all chipmakers were vertically integrated, meaning they designed the chip, built the tools to make them, ran the fabs and added the necessary connectors. As costs went up and certain activities became more and more complex, they were spun out to spread expenses and know-how. Semiconductor equipment, design software and packaging have long been done by separate companies. But the past ten years have seen the rise of "fabless" firms, which merely design integrated circuits.

Now established chipmakers can no longer afford to develop their own manufacturing processes or even to run their own fabs. To share the pain, IBM, Samsung and others have teamed up to use chipmaking technology jointly. Some firms, such as Texas Instruments, have chosen to go "fab-lite", meaning that they have their own fabs only for certain chips. Others, such as AMD, have spun off manufacturing completely (although AMD's decision had much to do with a lack of cash after it bought ATI, a maker of graphics chips, for $5.4 billion in 2006).

Hence the rise of "foundries", the smelters of the information age. These are essentially contract manufacturers. Although far from household names, they are huge companies, churning out about one quarter of the world's semiconductors. The biggest, TSMC, has a manufacturing capacity greater even than Intel's. Its revenues grew at an annual average rate of 13% for several years, topping $10.6 billion, before falling by almost a third in the last quarter of 2008.

TSMC also illustrates a corollary of Moore's Second Law: even the biggest chipmakers must keep expanding. Intel today accounts for 82% of global microprocessor revenue and has annual revenues of $37.6 billion because it understood this long ago. In the early 1980s, when Intel was a $700m company—pretty big for the time—Andy Grove, once Intel's boss, notorious for his paranoia, was not satisfied. "He would run around and tell everybody that we have to get to $1 billion," recalls Andy Bryant, the firm's chief administrative officer. "He knew that you had to have a certain size to stay in business."

Grow, grow, grow

Intel still appears to stick to this mantra, and is using the crisis to outgrow its competitors. In February Paul Otellini, its chief executive, said it would speed up plans to move many of its fabs to a new, 32-nanometre process at a cost of $7 billion over the next two years. This, he said, would preserve about 7,000 high-wage jobs in America. The investment (as well as Nehalem, Intel's new superfast chip for servers, which was released on March 30th) will also make life even harder for AMD, Intel's biggest remaining rival in the market for PC-type processors.

Two other long-term developments also point towards further concentration of chipmaking. The first is technological change beyond that ordained by Moore's Law. Fully automated "lights-out" fabs are in operation. Within a few years fabs will be producing wafers with a diameter of 450mm, up from 300mm now, making them even more productive. "When the industry goes to 450mm and this happens at 22 or even 11 nanometres, it is conceivable to have one factory handle all our needs as a company," says Mr Otellini. He adds, however, that Intel would never put all its eggs in one basket.

The other development is the maturing of the industry. Its annual growth has slid from double digits in the mid-1990s to an average of around 5% since then. And since 2004 the profitability of chip firms has dropped steadily as many chipmakers have lowered prices to expand their markets. In the future, only three types of semiconductor firm will make a decent return, predicts Mr Lidow: those with unique intellectual property; those happy to make commodity chips; and those with enough cash to achieve unprecedented scale.

How far will consolidation go? High-ranking executives at leading firms, who prefer not to be quoted, give similar answers. In the long run, they say, there will be only three viable entities, at least at the leading edge of chipmaking: Samsung in memory chips, Intel in microprocessors and TSMC in foundries. The rest will be "nationalistic" ventures in need of regular government bail-outs.

Yet such predictions may be a little off the mark. Largely because of that nationalism, the semiconductor industry is unlikely to end up as a bunch of near-monopolies. The Taiwanese are unlikely to let the South Koreans rule the memory roost. The newly founded Taiwan Memory Company (TMC), which is to take over the six local firms, could become the core of a global memory giant. It will hook up with Elpida Memory, Japan's sole maker of memory chips. TMC is also said to be interested in Qimonda.

As for microprocessors, in the fast-growing market for netbooks and other mobile devices, Intel has to do battle with many "fabless" firms, most of which build chips based on designs by ARM, a British company. What is more, after spinning off manufacturing, "our customers no longer have to ask: is AMD able to invest in the next generation of manufacturing?" says Dirk Meyer, the firm's chief executive. And Abu Dhabi's investment in Globalfoundries is part not just of its preparations for the post-oil age, but also of a long-term plan to create a "global" alternative to foundries in Taiwan and mainland China. The company will build a fab in New York state and perhaps one day in the Gulf state.

Bloomberg

Precious pizza

Whatever the precise number of firms, the semiconductor industry will be highly concentrated and much of it will be dominated by Asian companies. Does this matter? From a purely economic standpoint, probably not much. The industry's extreme capital-intensity is certainly a barrier to entry, and in theory a market with only a few suppliers is ripe for rigging. But chipmakers are unlikely to be able to extract a disproportionate rent or restrict supply—or even to try. For one thing, the industry has a history of intense competition. This is especially fierce among Asian national champions, for which prestige plays a big role. More important, the global production network of the information-technology industry is much too interdependent. If foundries, for instance, took a much larger piece of the pie, others in the value chain, such as chip designers, would find it hard to survive.

From a political perspective, the shift towards Asia could matter much more—especially for Europe. Although America has lost much of the "back end" of chipmaking—the packing and testing—to Asia, it still is the home of many leading-edge fabs, notably those run by Intel. Intel's finances, thanks to its dominance, are still healthy, but the big European chip firms such as STMicroelectronics (revenues of $9.8 billion in 2008), Infineon Technologies ($6 billion) and NXP Semiconductors ($5.4 billion) are struggling.

NXP has just announced a financial restructuring to lighten its debt burden of nearly $6 billion.

Worse, over the past ten years Europe's market share in semiconductors has dropped from more than 23% to about 15%, according to Future Horizons, a consultancy. A recent report by the European Semiconductor Industry Association (ESIA), a lobbying group, listed some of the reasons for this erosion: the appreciation of the euro, much more generous subsidies in other regions and lagging R&D spending. If governments do not act soon, the report concludes, chipmakers will continue to migrate elsewhere and put Europe's competitiveness at risk.

Although sophisticated chips are an essential ingredient of many European exports, from cars to medical equipment, the answer is unlikely to be a splurge of taxpayers' money. A lot has already been spent on manufacturing, to create jobs. But this approach will work even less well in the future. Trying to draw level with Asia in chipmaking would be futile.

What is more, although there has been a lack of spending on research, the real problem has been a lack of successful commercialisation. What Europe's semiconductor industry—and its technology sector as a whole, for that matter—badly needs is a better environment for entrepreneurs, says Dan Breznitz of the Georgia Institute of Technology, a specialist in the global IT industry. Because Europe's semiconductor industry has been dominated by big, hierarchical companies, fabless firms are still rare. In Israel, by contrast, with its newly entrepreneurial culture, they have multiplied. Europe, argues Mr Breznitz, is still too focused on manufacturing.

Europe could stage a comeback, some say, should an old idea finally take off: "mini-fabs"—small, flexible and agile production units. Such a revolution has happened before, in steel: giantism once seemed insuperable, yet today plenty of steel is made in "mini-mills", which use scrap as raw material. Might the foundries of the information age one day be under a similar threat? Maybe. But experts are right to be sceptical: transistors may get ever smaller, but in chipmaking scale rules.

Japan

The incredible shrinking economy

Apr 2nd 2009 | TOKYO
From The Economist print edition

Japan is in danger of suffering not one but two lost decades

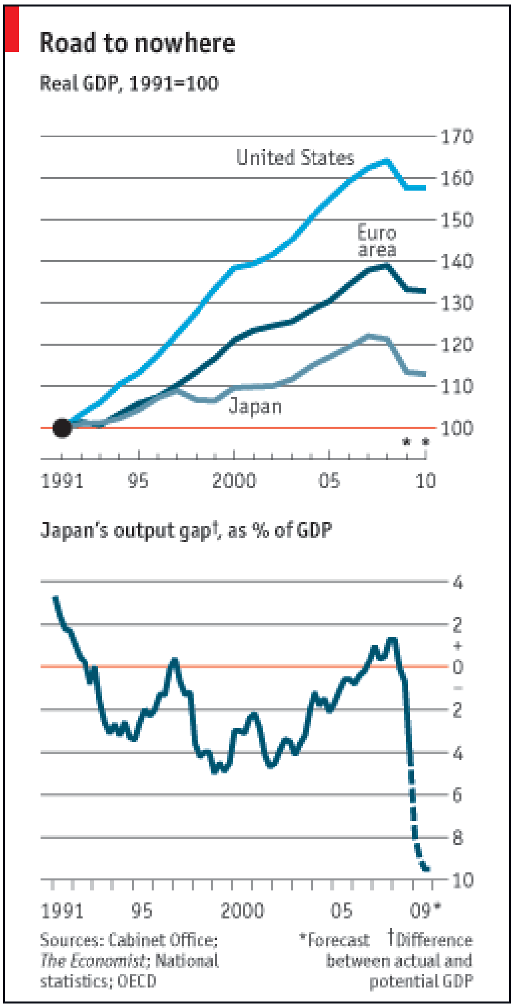
Illustration by S. Kambayashi

TO LOSE one decade may be regarded as a misfortune; to lose two looks like carelessness. Japan's economy stagnated in the 1990s after its stockmarket and property bubbles burst, but its more recent economic performance looks even more troubling. Industrial production plunged by 38% in the year to February, to its lowest level since 1983. Real GDP fell at an annualised rate of 12% in the fourth quarter of 2008, and may have declined even faster in the first three months of this year. The OECD forecasts that Japan's GDP will shrink by 6.6% in 2009 as a whole, wiping out all the gains from the previous five years of recovery.

If that turns out to be true, Japan's economy will have grown at an average of 0.6% a year since it first stumbled in 1991 (see top chart). Thanks to deflation as well, the value of GDP in nominal terms in the first quarter of this year probably fell back to where it was in 1993. For 16 years the economy has, in effect, gone nowhere.

Was Japan's seemingly strong recovery of 2003-07 an illusion? And why has the global crisis hit Japan much harder than other rich economies? Popular wisdom has it that Japan is overly dependent on exports, but the truth is a little more complicated. The share of exports in Japan's GDP is much smaller than in Germany or China and until recently was on a par with that in America. During the ten years to 2001, net exports contributed nothing to Japan's GDP growth. Then exports did surge, from 11% of GDP to 17% last year. If exporters' capital spending is included, net exports accounted for almost half of Japan's total GDP growth in the five years to 2007.

Exports boomed on the back of a super-cheap yen and America's consumer binge. Japan did not have housing or credit bubbles, but the undervalued yen encouraged a bubble of a different sort. Japanese exporters expanded capacity in the belief that the yen would stay low and global demand remain strong, resulting in a huge misallocation of resources.



As foreign demand collapsed and the yen soared last year, Japan's export "bubble" burst. Total exports have fallen by almost half in the past year. Japan's high-value products, such as cars and consumer electronics, are the first things people stop buying when the economy sours.

Richard Jerram, an economist at Macquarie Securities, argues that the worst may soon be over for industrial production. This year, output and exports have fallen by much more than the drop in demand, because firms have temporarily closed plants in order to slash excess stocks. For instance, Japan's vehicle production in the first two months of 2009 was 50% lower than a year before, but global car sales fell by only 25%.

Mr Jerram reckons that the inventory rundown is coming to an end, which will lead to a short-term bounce in output as factories reopen. If so, car output in June could be around 50% higher than in March (but still down by 25% on a year earlier). This means that GDP growth might turn positive in the second quarter even if foreign demand remains weak.

Unfortunately, the economy is likely to totter again as the second-round effects of tumbling profits and rising unemployment squeeze investment and consumer spending. According to the latest Tankan survey of the Bank of Japan (BOJ), in March business sentiment among big manufacturing firms was the gloomiest since the poll began in 1974. Manufacturers say they plan to cut investment by 20% this year. They are also trimming jobs and wages. The seemingly modest unemployment rate of 4.4% in February understates the pain. The ratio of job offers to applicants has declined to only 0.59, from around one at the start of 2008, and average hours worked have also fallen sharply. Average wages (including bonuses and overtime pay) went down by 2.7% in the 12 months to February. Household spending fell by 3.5% in real terms over the same period; department store sales plunged by 11.5%.

The weakening domestic economy has prompted the government to man the fiscal pumps. A stimulus of 1.4% of GDP is already in the pipeline for 2009, and a further boost of perhaps 2% of GDP is expected to be unveiled in mid-April. The package is likely to include measures to strengthen the safety net for the unemployed and so ease concerns about job security. There will also be new infrastructure spending. Much of the expenditure on public works in the 1990s is now considered wasteful, so this time the focus is meant to be on projects that boost productivity, such as an expansion of Tokyo's Haneda airport. Better crafted stimulus measures which raise long-run growth are also less likely to spook bond markets concerned about the government's vast debt.

So long as the extra measures are not delayed by an early election (which must be called by September), Japan's total fiscal stimulus in 2009 could be the largest among the G7 economies. But it would not be enough to prevent a sharp widening of the output gap (the difference between actual GDP and what the economy could produce at full capacity). This had already risen to 4% of GDP in the fourth quarter of 2008, and it is likely to approach 10% by the end of 2009, twice as much as in the 1990s downturn (see bottom chart, above).

This gaping economic hole is again putting downward pressure on prices. By late summer consumer prices could be more than 2% lower than a year before—a faster decline than during Japan's previous bout of deflation. The risk is that deflation will squeeze profits and hence jobs, thereby further depressing demand and prices. The BOJ cut interest rates to 0.1% in December and it has introduced several measures to keep credit flowing, such as buying commercial paper and corporate bonds, as well as shares held by banks, which boosts their capital ratios. In contrast to the 1990s, bank lending is still growing.

The BOJ has also stepped up its purchases of government bonds, but after its experience in 2001-06, the

bank remains sceptical that such “quantitative easing” can lift inflationary expectations and spur demand. One big difference is that the previous episode of quantitative easing coincided with stringent budget-tightening under Junichiro Koizumi, the then prime minister. The budget deficit was reduced from 8% of GDP in 2002 to 1.4% in 2006 (which partly explains why domestic demand was weak). The combination of fiscal expansion and government-bond purchases by the BOJ should work better.

The OECD predicts that public-sector debt will approach 200% of GDP in 2010, so the scope for further fiscal stimulus will be limited. Nor can Japan rely on exports for future growth; to the extent that it had enjoyed an export bubble, foreign demand will not return to its previous level. Japan needs to spur domestic spending.

One possible option, which the government is exploring, is to unlock the vast financial assets of the elderly. Japanese households’ stash of savings is equivalent to more than five times their disposable income, the highest of any G7 economy, and three-fifths of it is held by people over 60 years old. Gifts to children are taxed like ordinary income, but if this tax were reduced, increased transfers could boost consumption and housing investment since the young have a much higher propensity to consume. In theory, this could give a much bigger boost to the economy than any likely fiscal stimulus.

Of course, one reason why the elderly are cautious about running down their assets is concern about the mismanaged pension system and future nursing care. Services for the elderly should be among Japan’s fastest growing industries and create lots of new jobs, but they are held back by regulations which restrict competition and supply. Deregulation of services would not only help to improve the living standards of an ageing population, but by helping to unlock savings might also drag the economy out of deep recession.

Japan’s second lost decade holds worrying lessons for other rich economies. Its large fiscal stimulus succeeded in preventing a depression in the 1990s after its bubble burst—and others are surely correct to follow today. But Japan’s failure to spur a strong domestic recovery a decade later suggests that America and Europe may also have a long, hard journey ahead.

Mexico and the IMF

No strings attached

Apr 2nd 2009
From The Economist print edition

The IMF hopes a credit line for Mexico may set a trend

RUMOURS that a country is in talks with the IMF are often met with loud denials. That is because the fund's loans usually come with so many unpopular strings attached, such as public-spending cuts and interest-rate increases, that any government that approaches them is considered to be on its knees. Even the fund admits there is a stigma to borrowing from it.

All the more reason why an announcement by Felipe Calderón, Mexico's president, on March 31st caught people—including holders of his country's currency—by surprise. Amid the pomp of a state visit to London, he revealed that Mexico had secured a $47 billion credit line from the IMF, the first time it had received help from the fund since the 1995 peso crisis. The reason he was happy to be so forthcoming is that Mexico is accessing an IMF credit facility launched late last month with a complete lack of conditions. The Flexible Credit Line is aimed at countries that the IMF deems to be in good economic health but that are facing temporary financing difficulties. Mexico has no immediate plans to draw on it. However, on April 1st the central bank said it would tap a $30 billion currency swap from America's Federal Reserve.

Getty Images

Calderón and the queen: no stigma there

The credit line was designed with Mexico in mind but the IMF hopes that the country's involvement will induce others to follow. Its previous efforts to that effect had failed. A short-term lending facility introduced last October had no takers, even though it, too, placed no conditions on potential users. The Mexican announcement suggests that if the fund crafts its instruments carefully, it can attract borrowers.

The timing is also opportune. It came just days before the G20 meeting in London, at which leaders were due to discuss additional funding for the IMF—and, more controversially, who would supply it and on what terms. If Mexico is a trendsetter, the fund may well need more money. It has $150 billion available to lend, though Japan and the European Union have promised an additional $100 billion each. On the other hand, governments in many emerging economies feel the IMF needs a comprehensive overhaul of governance and quotas before it can be of use to them.

Mexico, for its part, hopes that the facility will reduce uncertainty as the economy suffers from its close links to crisis-hit America, and that it will allow the funding costs of Mexican companies to fall. In a positive sign, the peso surged after the announcement and prices of Mexican bonds strengthened. The peso has risen by 12% since falling to a 16-year low in early March. That is the sort of movement that may well bring other temporarily stricken nations to the IMF's door.

Economist.com FINANCE & ECONOMICS

Buttonwood

Minsky's moment

Apr 2nd 2009
From The Economist print edition

A new appraisal of an economist's theories challenges the blind faith in free markets

Illustration by S. Kambayashi

STABLE economies sow the seeds of their own destruction. That sounds like Karl Marx but it is the basic insight of Hyman Minsky, an economist of the mid-20th century whose reputation is being revived. Minsky argued that the financial system played a big role in exaggerating the economic cycle, one that was understated by conventional theory.

Investors, banks, companies and consumers all tend to be guilty of the sin of extrapolation; they assume the future will be like the recent past. After several years of steadily growing output and low inflation, people develop a misguided confidence that such benign conditions will continue. They are thus happy to borrow, and lend, more. As they do, the riskiness of the system steadily increases.

Minsky divided the process into three phases. In the first, investors take on little enough debt that they have no trouble meeting their capital and interest payments. In the second, they stretch their finances so they can only afford the interest. In the third, or Ponzi, phase they take on debt levels that require rising prices to be safely financed; the homebuyers who took on 125% mortgages at the peak of the property boom were a classic example.

When markets reach this fantasy land, a small change in the fundamentals or in investor attitudes can be enough to cause the system to unravel. Once prices start to drop, borrowers start to default on their loans, or seek to sell their assets, causing prices to fall further.

The cost of capitalism, to use the title of a new book* that draws heavily on Minsky's work, is first, that financial bubbles are created and second, that governments are forced to rescue the sector when those bubbles pop. Those who believe blindly in free markets are thus mistaken, in the view of Bob Barbera, a Wall Street economist and the book's author.

Government action is inevitable. In conventional industries, the demise of companies leads to "creative destruction" with capital being reallocated to more productive areas. But in banking and finance, a crisis leads to "deflationary destruction" as capital is eliminated. Businesses, investors and consumers lose confidence; borrowers are unable to repay their lenders, who suffer as well.

But by stepping in to rescue markets when they wobble, central bankers create asymmetric risk. Hence Mr Barbera rejects the idea, popular in the era of Alan Greenspan, that central banks should do nothing to burst asset bubbles.

Instead, he suggests that central banks should build the level of corporate-bond spreads into their models. When spreads are low, risk appetites are high, as they were in 2005-06. That should lead central banks to tighten monetary policy. When spreads are high, they should ease.

Whether that would have stopped the housing bubble is open to question. The Federal Reserve did indeed raise rates in 2005-06, albeit in a steady and unthreatening manner. Nevertheless, the current crisis suggests that monetary and fiscal policy cannot be driven exclusively by economic fundamentals such as inflation and unemployment. When interest rates are low, consumers and businesses do not just borrow money; they borrow money to buy assets, setting up a feedback loop that can eventually lead to a bubble. When such a bubble is inflating, government revenues (in the form of taxes on capital gains, bonuses, corporate profits and property sales) tend to be strong. As governments are now discovering, such revenues collapse very quickly when the bubble bursts.

But it is easy to get carried away during a boom; the strength of financial markets tends to be seen as a signal that the economy is soundly based. Those who work in the financial system are assumed to be the best and the brightest. Even the government seems to be in their thrall.

In a recent article, Simon Johnson, a former chief economist of the IMF, points out the parallels between emerging markets, where governments are dominated by the economic elite, and America, where officials glide easily between Wall Street and the Treasury. What is good for Goldman Sachs might turn out to be good for America, but it might be best if the government could make an independent judgment. If we accept Minsky's idea that financial markets are not always right, then we might be willing occasionally to act against Wall Street's interests, however loudly bankers would complain.

---

* "The Cost of Capitalism: Understanding Market Mayhem and Stabilising Our Economic Future", by Robert Barbera. Published by McGraw-Hill.

Buttonwood now writes a blog, which is open for comment at**Economist.com/blogs/buttonwood**

---

* "The Cost of Capitalism: Understanding Market Mayhem and Stabilising Our Economic Future", by Robert Barbera. Published by McGraw-Hill.

Buttonwood now writes a blog, which is open for comment at
Economist.com/blogs/buttonwood

Regulating banks

Basel brush

Apr 2nd 2009
From The Economist print edition

Regulators' new blueprint for bank supervision avoids the trickiest bits

IT HASN'T got to the stage of taxi drivers demanding a crackdown on tier-one capital, but in general terms the world agrees that banks need to be regulated until they weep. The detail is best left to the experts, and ahead of the G20 summit, they worked overtime, producing several big reports for the Financial Stability Forum (FSF), which brings together central banks, financial regulators and treasuries from the big Western economies.

Investors' confidence in the old rules, governed mainly by the Basel 2 regime, is at rock bottom and some fear that banks are still massaging their balance-sheets. One of London's leading investors in financial firms complains of "window dressing and truth dodging" which, he thinks, "gives the lie to the complacent assumption that nothing like Japan in the 1990s could ever happen in the West." That suggests tacit collusion by some regulators, possibly even those sitting on the FSF.

Against this backdrop of scepticism, the FSF has acted to close many of the loopholes banks had exploited. Off-balance-sheet vehicles, models that allow capital ratios to be gamed by understating assets' risks, over-reliance on wholesale funding and gung-ho compensation policies will all be *verboten*. Simple ratios of equity to assets will be monitored, as well as the more fiddly risk-based approach of Basel 2. Banks will be required to build up capital during the good times, although the exact mechanism and amounts of capital have yet to be decided. Regulators will have to scrutinise the risk of the system overall and not just that of individual lenders.

That is the easy bit. The FSF sidesteps several trickier issues. One is mark-to-market accounting where it is ambivalent, for example endorsing the idea that banks be allowed to shift assets into loan books where they need not be written down immediately. That is unfortunate given that political pressure and intense lobbying by banks now seem likely to force American standard-setters to water down their rules. It may also be inconsistent with America's toxic-asset plan, which needs loans and securities to be carried at market-clearing prices to work. If the thrust of the new capital rules is to create conservative standards and to reduce management discretion over them, it seems odd not to endorse the same principles for accounting.

The FSF shies away from discussing enforcement. The old system failed partly because the rules were flawed, but also because regulators were captured: witness supervisors' decision to allow the leveraged takeover of ABN AMRO, a Dutch lender; the widespread use of hybrid debt to inflate capital; and the permissive stance of the Securities and Exchange Commission towards American broker-dealers like Lehman Brothers. This time the rules need to be enforced, and that may require a big shake-up of the regulators themselves.

Finally, consider the taxi driver. He may accept that the banks needed to be bailed out, but in the future wants to protect his high-street bank, which enjoys implicit taxpayer backing, from the risk-takers who should live and die by the sword. Yet the industry has moved in the opposite direction. Deposit-taking giants such as JPMorgan Chase and Bank of America have bought investment banks, and bailed-out lenders such as Royal Bank of Scotland, Citigroup and UBS plan on keeping much of their investment-banking units intact. The FSF has addressed the fine print, but the question of how to ensure taxpayers do not underwrite private risk-taking again remains unanswered.

The black market

Notes from the underground

Apr 2nd 2009
From The Economist print edition

At least one part of the economy is growing. Sadly it is the wrong part

“WE USED to be recession-proof. No more. You can’t blame it all on the Justice Department,” laments Uncle Junior in “The Sopranos”. Life may be hard for fictitious television mobsters such as Tony Soprano, a self-styled “waste-management consultant”, but in other parts of the black economy, business is alive and well. As pressures bear down on profits, restaurateurs become street vendors, shopkeepers become stallholders, and as for work permits at the building site, fuhgedaboudit!

The shadow economy is just about the only part of the economy that may be growing. According to Friedrich Schneider, a professor at the Johannes Kepler University of Linz and one of the world’s experts on the topic, that would mark a turnaround in its fortunes after nearly a decade of decline. He has estimated the value-added of the shadow economy in 21 of the 30 OECD countries. On average, it was equivalent to 16.8% of GDP in 1999. By 2008 that figure had fallen to 13.3%. This year he forecasts it will rise to 13.8%. Mr Schneider’s calculations do not include activities which are illegal in themselves.

AP

What credit crunch?

In spite of its size, the shadow economy’s elusive character frustrates easy attempts to measure it. Simply asking people has obvious shortcomings. Tax-compliance data can be used and discrepancies in national income and expenditure accounts give a sense of what is going on in between the formal and informal sectors. Sometimes employment data can be revealing. Last month, registered unemployment in Poland was reported to have risen from 9.5% in December to 10.5% in January, but a survey found that actual unemployment, excluding workers in the grey economy, had only edged higher. A week later Polish labour unions decried the continued influx of cheap unregulated labour from farther east.

Yet another way to gauge its size is to look at electricity demand, which moves roughly in step with economic activity. If it is high and official GDP low, the informal economy is probably flourishing. Most experts, however, use a mixture of more advanced methods. Since cash is the lifeblood of the informal economy, it is possible to look at cash demand in bank data and tease out the proportion of cash holdings which cannot be explained by other factors.

According to Mr Schneider, who uses a combination of two even more complicated statistical methods, the size of the underground economy is equivalent to less than 8% of GDP in the United States, whereas in Greece it reaches 25% and in Italy 22%. In Italy, of course, the Mafia still makes out handsomely. That’s one firm that doesn’t have a cash problem.

Spanish banks

The mess in La Mancha

Apr 2nd 2009
From The Economist print edition

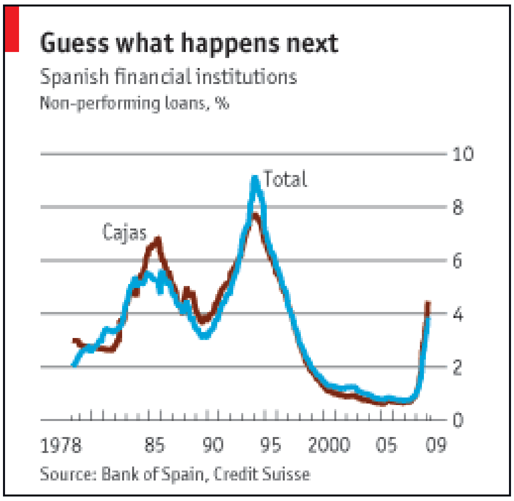
Part of Spain's bad-debt problem is hidden within its savings banks

PESSIMISTS about Spain's economy are as oversupplied as flats in the concrete ghost towns on the edge of Madrid. Unemployment could hit 20% next year and common sense suggests a bad-debt problem will eventually hit the banking system. House prices were as barmy as in America and Britain, rising by almost two and half times from 2000 to the peak. And Spain's cement mixers were on fire: three-quarters of a million homes were built in 2006, half the number in America, whose population is seven times larger.

While debt investors have been giving Spanish government bonds an extra sniff and property firms have tottered, the banks have appeared to be Teflon-coated. The two biggest, Santander and BBVA, have beaten international competitors, partly thanks, if Spain's supervisors are to be believed, to good regulation. The bail-out on March 29th of a small savings bank, Caja Castilla La Mancha, could change that perception. The government's liquidity package of up to €9 billion ($12 billion), which will probably be bolstered with equity, is a reminder that many of Spain's bad debts fester outside the listed banks.

Spain's *cajas* are mutually owned and controlled by a mix of depositors, employees and local politicians, and they distribute a big chunk of their profits to local causes. Since the 1960s they have increased their market share of loans from about 10% to 50% by opening branches in smaller cities and by extending credit to people and businesses ignored by the market leaders. When the big two banks put the brakes on in 2006-07, the *cajas* continued lending more keenly, tapping wholesale debt markets to fund themselves. That alone makes them higher risk. But the savings banks also supplied about half of the €318 billion borrowed by Spain's property developers. These loans now represent about a fifth of the *cajas*' assets, according to Santiago López Díaz, an analyst at Credit Suisse. They are deteriorating fast.

The exact state of Castilla La Mancha is unclear and a restatement of its accounts is likely. But taken together, by January 4.5% of all the *cajas*' loans had gone sour, compared with 3.9% for the banking system. The pace of deterioration (see chart) threatens to overwhelm the scope of reserves, capital and ongoing profits to absorb losses. Mr López Díaz reckons that 9% of the *cajas*' total loans could become non-performing, and within that a fifth of the loans made to property developers. Assuming this, the *cajas* could need €60 billion of new equity, on top of the €64 billion they already have. Sales of the stakes the savings banks hold in Spanish companies and takeovers of laggards by the healthier ones could fund some of that. But the government would probably be on the hook for most of it.



The Bank of Spain contends that the problem is manageable, but a large bail-out looks inevitable and will be complicated by the politicised governance of the *cajas*. The episode is a reminder that banks' woes have moved on from mark-to-market losses on esoteric trading assets to big hits on traditional loan books. Spain may have just undertaken the first bail-out of the second act of the banking crisis.

Gold

Bullish on bullion

Apr 2nd 2009
From The Economist print edition

Some investors want savings that they can caress

AROUND the corner from *The Economist*'s offices in Mayfair, a shop dealing in old coins has a faded notice in the window. It advertises what were once daily prices for Krugerrands—gold coins from South Africa—and dates back to times when trade in such coins was brisk.

The heyday for buying physical gold was in the early 1980s, when bullion reached its peak in real terms. Once again, business is picking up. According to the World Gold Council, retail demand for bullion in the fourth quarter of 2008 was almost five times what it was in the same period of 2007. Dealers report a surge in interest from those worried about the safety of banks or simply the lack of attractive alternatives to negligible deposit rates and volatile stockmarkets. Fanning such fears are those who argue that today's financial crisis does not so much resemble the Depression of the 1930s as the hyperinflationary Weimar era of 1923.

EPA

Golden era

Sandra Conway of ATS Bullion, which operates out of discreet offices in central London, says there was a big rush after the demise of Lehman Brothers in September. "People want something tangible in their hands as a safeguard," she says. One ATS client saves up all his £2 coins ($2.90) until he has enough to buy a sovereign, a gold coin minted by the British government. But coins tend to attract a markup, based on both scarcity value and the cost of manufacture; according to Ms Conway, Krugerrands trade at about 13% above the spot price.

The alternative is gold bars, where the markup reduces significantly with size (to about 5%). A kilo costs around £20,000. Oliver Temple runs Gold Investments, a business started by his father and run out of fairly dishevelled offices in the City of London. After rummaging in a drawer, he pulls out a troy-ounce bar, a sliver of a thing worth more than $900 at current prices. "People assume that, if everything else in the world goes wrong, gold will hold its value," he says.

It may seem odd that people want the risk of keeping gold at home (or the cost of storing it at a bank), when they can invest in exchange-traded funds (ETFs) that track the gold price. But Ms Conway says that people are suspicious, in a real meltdown, of whether their claim on gold held in an ETF would be honoured.

Whether true or not, old-fashioned coins have been a shrewd bet so far. Ms Conway points out that Krugerrands bought for £200 or so in 2005 are now worth more than £700.

Economics focus

The grass is always greener

Apr 2nd 2009
From The Economist print edition

Saving the planet and creating jobs may be incompatible

Illustration by Jac Depczyk

"THINK of what's happening in countries like Spain, Germany and Japan where they're making real investments in renewable energy," Barack Obama instructed Americans earlier this year. "They're surging ahead of us, poised to take the lead in these new industries. This isn't because they're smarter than us, or work harder than us, or are more innovative than we are. It's because their governments have harnessed their people's hard work and ingenuity with bold investments—investments that are paying off in good, high-wage jobs."

Mr Obama is right that many governments, not least his own, are spending heavily in a bid to create green jobs. Countries as diverse as Canada, China, France and Indonesia have vowed to cultivate greenery in an effort to fertilise their wilting economies. Religious leaders, trade unionists and the secretary-general of the United Nations, among others, have hailed green stimulus as a cure for the world economy's ills. After all, it holds out the hope of a triple benefit: a return to economic growth, deliverance from global warming and an escape from dependence on imported fuels, all wrapped up in an appealingly high-tech package.

There is no shortage of studies on green jobs that support this optimistic view. The Center for American Progress, a think-tank with close ties to Mr Obama's administration, called last year for the government to spend $100 billion on various green initiatives. The reward, it calculated, would be 2m jobs.

Roland Berger, a firm of consultants, wants the German government to do something similar. It estimates that global spending on environmental technology is €1 trillion ($1.3 trillion) a year, and will grow by 5.4% a year until 2020. This business sustains 1.5m jobs in Germany, by its reckoning. But the number could double, the consultants believe, if the government offered more tax breaks, subsidies and other incentives for investment in greenery. The United Nations Environment Programme has produced a report lauding government schemes to promote green employment. It sees scope for ten times as many jobs in clean energy by 2030.

Critics of these studies, however, argue that they leave important questions unasked. For one thing, it is hard to know how impressive the employment figures are without considering how many jobs would be created by spending the money in other ways. A recent paper from the Peterson Institute of International Economics and the World Resources Institute, two think-tanks, tries to do just that for America's stimulus

package. It finds that $1 billion in green-tinted spending creates 30,100 "job-years". That compares well with 25,200 job-years for road construction and only 7,000 for temporary tax cuts (permanent ones do better).

The green stimulus schemes the authors looked at perform so well because they catalyse private investment in things like windmills and fuel-efficient cars. But that also flatters the employment numbers, in so far as the authors assume that the stimulus induces private spending that would not otherwise occur. They note that if it simply redirects capital from one use to another, then the number of jobs created might not be so great.

What is more, public investment in green technology brings costs as well as benefits. Taxpayers, for example, will ultimately have to pay for government debt, while prodigious government borrowing makes it harder for businesses to raise money. Spending on renewable electricity, meanwhile, tends to raise the price of power, since wind- and solar-power plants cost more to build and run than coal-fired ones, say. These effects can cost jobs.

In 2006, in a study prepared for a pro-coal lobbying group, Adam Rose and Dan Wei of Pennsylvania State University looked at how increasing the share of renewables in electricity generation at the expense of coal might affect employment. Displacing a third of generation from coal by 2015 would put 1.2m people out of work, they concluded, and displacing two-thirds would raise the figure to 2.7m. The job losses came chiefly as a result of higher energy prices.

Those findings, however, are based on modelling, with all the complications and caveats that entails. Mr Rose's subsequent research, using different assumptions, has produced more ambiguous results. By contrast, Gabriel Calzada Álvarez, a professor at King Juan Carlos University in Madrid, has tried to use empirical data to estimate how Spain's subsidies for renewables, which so impressed Mr Obama, will affect employment. He calculates that the subsidies for existing renewable-electricity plants, which the government has promised to pay for 25 years, will cost €29 billion. Those subsidies, in turn, have created 50,200 jobs, according to data from the European Commission. That equates to a subsidy of over €570,000 per job.

Solar eclipse

Spain's private sector, on the other hand, creates a job for every €260,000 or so invested, by Mr Calzada's reckoning. So if the government had left the €29 billion in the hands of the private sector, it would have created 113,000 jobs with it—2.2 times as many. In other words, the government, Mr Calzada finds, is destroying 2.2 ordinary jobs for every green one it creates.

The result is particularly garish because Spain's subsidies for renewables have been so generous (it recently scaled them back for new projects). Green subsidies bring other benefits that Mr Calzada does not consider, such as reducing demand for, and thus the price of, fossil fuels. The biggest benefit of all, of course, is to the environment, in the form of reduced emissions of greenhouse gases. Taking all of that into account would doubtless make the numbers look better. Nonetheless, Mr Calzada's paper does suggest that Mr Obama should temper his enthusiasm for Spain's "bold investments" in renewable energy. As all the studies discussed suggest, some ways of creating jobs—or fighting global warming, for that matter—are cheaper than others.

Marjorie Deane internship

Apr 2nd 2009
From The Economist print edition

Applications are invited for the 2009 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a promising journalist or would-be journalist, who will spend three months of the summer at *The Economist*, writing about economics and finance. Applicants may also be considered, if they wish, for an internship of similar duration at *CFO Europe*, a sister publication of *The Economist*. Applicants should send a letter introducing themselves, with an original article of no more than 500 words that they think would be suitable for publication in this section of *The Economist*. Applications should be sent by e-mail to deaneintern@economist.com or posted to the Business Affairs Editor (Deane internship), The Economist, 25 St James's Street, London, SW1A 1HG. They must reach us by April 24th.

Correction: Globalisation and trade

Apr 2nd 2009
From The Economist print edition

In our article on globalisation and trade published on March 26th 2009 ("The nuts and bolts come apart"), we misspelled the surname of Chad Bown, of Brandeis University's International Business School. Apologies. This has been corrected online.

Neuroscience and social deprivation

I am just a poor boy though my story's seldom told

Apr 2nd 2009
From The Economist print edition

How poverty passes from generation to generation is now becoming clearer. The answer lies in the effect of stress on two particular parts of the brain

Panos

THAT the children of the poor underachieve in later life, and thus remain poor themselves, is one of the enduring problems of society. Sociologists have studied and described it. Socialists have tried to abolish it by dictatorship and central planning. Liberals have preferred democracy and opportunity. But nobody has truly understood what causes it. Until, perhaps, now.

The crucial breakthrough was made three years ago, when Martha Farah of the University of Pennsylvania showed that the working memories of children who have been raised in poverty have smaller capacities than those of middle-class children. Working memory is the ability to hold bits of information in the brain for current use—the digits of a phone number, for example. It is crucial for comprehending languages, for reading and for solving problems. Entry into the working memory is also a prerequisite for something to be learnt permanently as part of declarative memory—the stuff a person knows explicitly, like the dates of famous battles, rather than what he knows implicitly, like how to ride a bicycle.

Since Dr Farah's discovery, Gary Evans and Michelle Schamberg of Cornell University have studied the phenomenon in more detail. As they report in this week's *Proceedings of the National Academy of Sciences*, they have found that the reduced capacity of the memories of the poor is almost certainly the result of stress affecting the way that childish brains develop.

Dr Evans's and Dr Schamberg's volunteers were 195 participants in a long-term sociological and medical study that Dr Evans is carrying out in New York state. At the time, the participants were 17 years old. All are white, and the numbers of men and women are about equal.

Stress in the city

To measure the amount of stress an individual had suffered over the course of his life, the two researchers used an index known as allostatic load. This is a combination of the values of six variables: diastolic and systolic blood pressure; the concentrations of three stress-related hormones; and the body-mass index, a measure of obesity. For all six, a higher value indicates a more stressful life; and for all six, the values were higher, on average, in poor children than in those who were middle class. Moreover, because Dr Evans's wider study had followed the participants from birth, the two researchers were able to estimate

what proportion of each child's life had been spent in poverty. That more precise figure, too, was correlated with the allostatic load.

The capacity of a 17-year-old's working memory was also correlated with allostatic load. Those who had spent their whole lives in poverty could hold an average of 8.5 items in their memory at any time. Those brought up in a middle-class family could manage 9.4, and those whose economic and social experiences had been mixed were in the middle.

These two correlations do not by themselves prove that chronic stress damages the memory, but Dr Evans and Dr Schamberg then applied a statistical technique called hierarchical regression to the results. They were able to use this to remove the effect of allostatic load on the relationship between poverty and memory discovered originally by Dr Farah. When they did so, that relationship disappeared. In other words, the diminution of memory in the poorer members of their study was entirely explained by stress, rather than by any more general aspect of poverty.

To confirm this result, the researchers also looked at characteristics such as each participant's birthweight, his mother's age when she gave birth, the mother's level of education and her marital status, all of which differ, on average, between the poor and the middle classes. None of these characteristics had any effect. Nor did a mother's own stress levels.

That stress, and stress alone, is responsible for damaging the working memories of poor children thus looks like a strong hypothesis. It is also backed up by work done on both people and laboratory animals, which shows that stress changes the activity of neurotransmitters, the chemicals that carry signals from one nerve cell to another in the brain. Stress also suppresses the generation of new nerve cells in the brain, and causes the "remodelling" of existing ones. Most significantly of all, it shrinks the volume of the prefrontal cortex and the hippocampus. These are the parts of the brain most closely associated with working memory.

Children with stressed lives, then, find it harder to learn. Put pejoratively, they are stupider. It is not surprising that they do less well at school, end up poor as adults and often visit the same circumstances on their own children.

Dr Evans's and Dr Schamberg's study does not examine the nature of the stress that the children of the poor are exposed to, but it is now well established that poor adults live stressful lives, and not just for the obvious reason that poverty brings uncertainty about the future. The main reason poor people are stressed is that they are at the bottom of the social heap as well as the financial one.

Sir Michael Marmot, of University College London, and his intellectual successors have shown repeatedly that people at the bottom of social hierarchies experience much more stress in their daily lives than those at the top—and suffer the consequences in their health. Even quite young children are socially sensitive beings and aware of such things.

So, it may not be necessary to look any further than their place in the pecking order to explain what Dr Evans and Dr Schamberg have discovered in their research into the children of the poor. The Bible says, "the poor you will always have with you." Dr Evans and Dr Schamberg may have provided an important part of the explanation why.

Astrophysics

Ethereal wisps

Apr 2nd 2009
From The Economist print edition

Another possible glimpse of dark matter

ONE of the great mysteries of the universe is what it is made of. The world, as perceived by those who inhabit it, consists of tangible matter, but this explanation cannot be complete. Most galaxies rotate at a speed that should cause them to fly apart if all that holds their visible matter together is gravity. Physicists think the universe is stuffed with invisible dark matter composed of particles very different from the ones that make up visible matter, and that the gravity of this dark matter holds galaxies together. Now a team of physicists think they may have seen direct evidence of this ghostly material.

Piergiorgio Picozza of the University of Rome Tor Vergata and his colleagues began by investigating a second great mystery: why the universe exists at all. The Big Bang created equal quantities of matter and antimatter. When the two meet, they annihilate each other. So the universe should have been destroyed soon after it was created. That it has not suggests that something must have happened to much of the antimatter, allowing matter to clump together to form stars, planets and, eventually, people.

Dr Picozza and his colleagues decided to look for clues in cosmic rays. These “rays” are actually streams of particles from outer space that constantly bombard the Earth’s upper atmosphere. Most of them are protons, one of the core constituents of any atomic nucleus, but others are more exotic. Dr Picozza and his colleagues wanted to examine any antimatter contained in the cosmic rays. To do so, they used a particle detector aboard a satellite.

First they found some relatively mundane low-energy positrons, the antimatter equivalent of electrons. Such positrons are produced by what researchers call secondary sources—mainly collisions between the protons contained in cosmic rays and atoms drifting through space. However Dr Picozza and his colleagues then discovered high-energy positrons. These are much more exciting because they must have been produced by primary sources, such as exotic stars or, perhaps, the disintegration of dark matter. Indeed, the team found that, at the highest energies they could measure, the ratio of positrons to electrons was far higher than at lower energies.

Exactly what might be causing the increase is another mystery. It could be a rapidly rotating, extremely dense neutron star called a pulsar. It could be a microquasar, a system in which a sun-like star and a neutron star orbit one another. It could also be explained by the annihilation of dark matter, the physicists report in *Nature*.

Physicists have long wondered about dark matter. One of the most popular explanations is that it consists of weakly interacting massive particles, also known as WIMPs. As the name suggests, these particles are massive, which is why their presence is revealed by gravity. By calling them “weakly interacting”, physicists mean that the particles experience another of the four fundamental forces, namely, the weak nuclear force that is responsible for radioactive decay.

Dr Picozza and his colleagues think that the high-energy positrons that they have detected may come from a WIMP either annihilated by a collision with an anti-WIMP or simply decaying, as many particles do after a time. They are now using their satellite-borne particle detector to examine what happens at even higher energies. This should help them to discriminate between the different explanations.

If the alternatives can be ruled out, then this will be the latest glimpse of dark matter. Other possible previous sightings include reports of collisions between clusters of galaxies that would appear to have separated dark matter from its visible counterpart. Indeed, many physicists now suspect that dark matter may provide the scaffold on which visible matter is arranged. When the Large Hadron Collider finally begins work in September at CERN, the European particle-physics laboratory in Geneva, it should also provide more clues. That the universe is filled with matter people cannot see—matter that simply passes through pretty much everything undetected—is hard to accept. But evidence is now accruing to suggest that it is true.

Biometrics

Knobbly ID

Apr 2nd 2009
From The Economist print edition

Analysis of knees could be used to confirm people's identities

ONCE the art of disguise would rely on a false moustache, a wig and probably a touch of make-up to foil an identification check. Today you need to beat an electronic fingerprint-analyser or a retinal scanner. It can be done with contact lenses designed to mislead eye scanners and some stick-on false fingerprints. But a new method of identification may prove much harder to evade with fake body parts.

Knees, it turns out, also have unique characteristics. An X-ray of a person's knee can show if he limps or was injured in a sporting accident, even if it happened years ago. Hospital records often contain lots of pictures of knees.

Lior Shamir, a geneticist at the National Institutes of Health in Maryland, has developed a knee-analysing mathematical algorithm for medical use. Algorithms are used by computers to analyse knee images in order to compare and contrast tiny structures in the joint that might indicate diseases like osteoarthritis. Computers make this work less labour-intensive. Dr Shamir and his colleagues now think his algorithm could identify individuals as well.

To find out, they used the algorithm to explore X-ray images of the general structure of various knees and then to look in greater detail by measuring the texture of the bone by monitoring differences in individual picture points, called pixels. The researchers found that analysing fine details at this level was roughly equivalent to studying fingerprints. The best identification was possible by concentrating on a smaller image of the centre of the joint rather than the entire knee.

The researchers tested the technique on 425 people, who each had four X-rays taken of their knees. The knee images were then digitised for processing by a computer using the algorithm. Three of the X-rays of each person were matched to the individual they came from. The fourth image of each person was then analysed anonymously and the computer instructed to search for a match.

The team report in the *International Journal of Biometrics* that the system was able to match a knee to an individual correctly 34% of the time. It was also able to pick the ten closest matches to a particular knee 56% of the time. Although this is far short of the nearly perfect scores of retinal scans and fingerprinting, the work is at an early stage and the researchers expect that with fine tuning the analysis will become more accurate.

They are planning to tweak the algorithm to look at more features of the knee and to try magnetic-resonance imaging (MRI) to produce images of soft tissue in greater detail. The use of MRI would also allow more frequent scans for identification purposes by avoiding the potential risk of X-rays. The possible uses include high-security checks and forensic work. And the time may yet come when, before you board an aeroplane, a security guard will want a good look at your knees.

Mining safety

Bash for help

Apr 2nd 2009
From The Economist print edition

A new way to find trapped miners

HIGH technology is not always needed to solve a problem. Indeed, a proposed new system for finding miners trapped by an underground collapse is activated simply by hammering on an iron plate with a sledgehammer. Rescuers can be not only alerted by the banging but also guided precisely to the scene.

Sensitive listening equipment has long been used to try to hear people trapped underground. It is possible to detect seismic waves created by miners hitting rocks, say, but it can be difficult to distinguish these from other underground noises.

Now a more accurate method has been found. It involves bolting iron plates to the walls of tunnels at regular intervals and placing sledgehammers nearby. The idea is that, in the event of a collapse, survivors able to reach one of the plates would bash it to create vibrations that are detected by a string of geophones, standard devices used to measure seismic activity, placed on the surface along the line of the mine.

Gerard Schuster and his colleagues at the University of Utah first tested the idea in a tunnel that carries pipes three metres below the university campus. After positioning the plates, the researchers listened to the sound that each one made on being struck. Every sound was unique, in part because of small variations in the geology surrounding the plates. They used a computer monitoring the string of geophones to analyse the signals to see if they contained the seismic fingerprint of any of the underground plates. The system could detect if a plate was being hammered and which one, thus indicating the location of the person hitting it.

The geophysicists went on to conduct a second test in an abandoned copper mine in Arizona, using 25 iron plates spaced at various intervals in tunnels up to 45 metres below ground. This also proved to be accurate. Dr Schuster says they are now looking for a working mine with tunnels one kilometre deep to conduct more experiments. Computer simulations suggest the distress signal should still be capable of being detected. They report their work in *Leading Edge*, a journal of the Society of Exploration Geophysicists.

The system could be used to send coded messages, perhaps in Morse, to the surface. Two-way communication might also be possible if the stations were equipped with seismic sensors and laptop computers. But for now, its potential as a cheap alert and location system is what interests the researchers. They estimate that it could cost about $100,000 to equip a mine with 100 emergency stations.

Working underground is dangerous even in the most developed countries. Six miners and three rescuers were killed in a collapse at the Crandall Canyon coal mine in Utah in August 2007. For those toiling far below the surface of the Earth, the proposed system could prove a godsend.

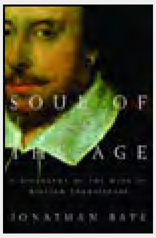
William Shakespeare

Soul of the age

Apr 2nd 2009
From The Economist print edition

You can learn a lot about Shakespeare by studying the world he inhabited

Soul of the Age: A Biography of the Mind of William Shakespeare
By Jonathan Bate



Random House; 496 pages; $35. Viking; £25

Buy it at
Amazon.com
Amazon.co.uk

IN HIS 1997 book, "The Genius of Shakespeare", Jonathan Bate wrote about the man whom Ben Jonson, a rival playwright, poet and actor, described as "not of the age, but for all time". In his new book, which is being published in America this month (it came out in Britain in October), Mr Bate explores a different Shakespeare, one Jonson described as "Soul of the Age!", the man who stood for and expressed the essence of his generation.

The effect, curiously, is not to distance the man, but to sharpen him. Approaching him locally, with connections to specific places and people, with certain books on his desk, and an eye out for particular political and diplomatic pitfalls—all this brings Shakespeare into focus. Not that any biographer has much hard fact to work on. As Mr Bate says, Shakespeare is elusive in every way: in his politics, religion, sexuality and in everything else that matters. The trick, it seems, is to pay very close attention to what evidence there is, not to take anything for granted and, well, to know a great deal about his world.

Take Gloucestershire, for example, or even Warwickshire. It turns out that Shakespeare was the only dramatist of the period to stage scenes in these counties. (The Justice Shallow bits, with their intensely local country references in the second part of "Henry IV" come especially to mind.) At first glance this is nice to know, but no more than a dab of colour on the hills-and-dales Shakespeare who sits alongside the court-and-tavern one. What we don't think of in this connection is maps—or rather Christopher Saxton's map of England, published in 1579, and Marcus Gheeraerts the Younger's portrait of Queen Elizabeth I standing on this map, her foot somewhere in Oxfordshire.

The Saxton maps (there were separate county maps too) were the first to show England to itself in any detail: roads, towns, rivers, every crook and corner. They were part of the great Elizabethan project for an English Protestant national identity. They demonstrated the extent of the monarch's reach. But as Mr Bate points out, this cut both ways. For they also gave people a sense of belonging to the land itself as much as to the crown. Shakespeare's career, he argues, was more evenly split between London and Warwickshire, town and country, than is generally supposed. This duality influenced the whole structure of his thought, feeding in to the idea of a deep England, an England that wasn't London. It is a long story, with many branches, and Mr Bate teases it out with the mixture of precise, wide-ranging historical, biographical and literary scholarship that distinguishes the book as a whole.

Mr Bate arranges his material around the seven ages of man, as in the melancholy Jacques's "All the world's a stage" speech from "As You Like It". Even so, this is not straight chronological Shakespeare. It almost doesn't matter in what order you read the book. The fascinating account of Shakespeare's Latin training, and how it shaped his use of language, should be read early. Mr Bate's later discussions, particularly of "The Tempest", show how intricately he counterpointed the classical and Christian traditions. But the section on the Essex rebellion and the role of Shakespeare's potentially subversive "Richard II" (a play about a monarch deposed and assassinated) can be read, thrillingly, on its own. Mr Bate dusts off the much-told story, and brings his man much closer to real danger. Luckily for us, it was Sir John Hayward, author of a Shakespeare-influenced history of Richard II, who was thrown in the Tower and interrogated when treason was the cry.

So what was Shakespeare like? Canny, sceptical, sympathetic: might Enobarbus, the humorously detached and yet emotionally entangled friend of Cleopatra's Antony come closest to him, Mr Bate wonders? A constant theme is Shakespeare's resistance to definition. He offered "questions and debates, not propaganda and positions". Just as he has been appropriated, so he appropriated ideas from

everyone else. On balance, Mr Bate suggests, the humane realism of Epicurus, an ancient Greek philosopher, whose pliableness and variety of mind Shakespeare would have encountered indirectly through the essays of Montaigne, is a good place to start.

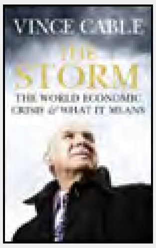
Soul of the Age: A Biography of the Mind of William Shakespeare.
By Jonathan Bate.
Random House; 496 pages; $35. Viking; £25

Vince Cable

Spirit of the age

Apr 2nd 2009
From The Economist print edition

The Storm: The World Economic Crisis & What it Means
By Vince Cable



Atlantic Books; 181 pages; £14.99

Buy it at
Amazon.co.uk

VINCE CABLE is a phenomenon of our troubled times. By some measure, Mr Cable, the economics spokesman of the Liberal Democrats, the smallest of Britain's big three political parties, is the most popular politician in Britain. In any putative government of national unity, he would be the default choice to be chancellor of the exchequer. What is all the more remarkable about Mr Cable's improbable standing is that he is admired in almost equal measure by other politicians and a cynical public.

His celebrity owes nothing to charisma or youthful good looks. Indeed, on two fairly recent occasions, when the leadership of his party fell vacant, he was judged to be so lacking in both that it would be futile for him even to stand as a candidate. Two things explain Mr Cable's present status as "the sage of Twickenham" (his parliamentary constituency). The first is that he was the only major politician consistently to warn about the threat of Britain's debt mountain, both private and public, to the long-term stability of the economy. Indeed, he has been banging on persistently about excessive credit expansion and the dangers of asset-price inflation for at least six years—a lone voice in a sea of complacency.

The second is that Mr Cable's rather austere appearance (he could easily be a stern headmaster or a bank manager) belies both a biting wit and a passionate nature. While serving as acting leader of his party 16 months ago, he drily observed of the hapless Gordon Brown: "The House has noticed the prime minister's remarkable transformation in the last few weeks from Stalin to Mr Bean." During a recent appearance on Desert Island Discs, a radio programme, he spoke movingly about his two marriages (his first wife, Olympia, died in 2001) and his love of ballroom dancing.

Consequently, the little book that Mr Cable, a former chief economist with Shell, has written to explain the economic crisis and to offer his prescriptions for dealing with it will reach a wider and more receptive audience than most such tracts. It deserves to do so. As an account of what happened and why, it is both admirably clear of befuddling jargon and authoritative in its range and detail.

Where Mr Cable could be accused of falling short is that nearly all his policy recommendations are of the kind that few sensible people could object to. He calls on politicians to resist the clamour in many countries, particularly America, for beggar-my-neighbour protectionism. He supports an internationally co-ordinated fiscal stimulus and the use of bad banks to mop up toxic assets. Looking to the future, he believes that monetary authorities must do more to lean against excessive exuberance when the next boom is under way by targeting asset-price inflation and drawing up new rules for assessing the capital adequacy of banks. Mr Cable also wants bankers' bonuses to be paid largely in stock, redeemable only after several years, and mortgages to be conditional on the down payment of substantial deposits.

The one controversial note (apart from a slightly half-hearted plea for Britain to join the euro zone) is a call to governments to address the growth of inequality that has characterised the past quarter-century, especially in Anglo-Saxon societies. Mr Cable thinks this was tolerated only because it was erroneously believed to be the price of economic dynamism.

Intellectually, Mr Cable is never less than a doughty defender of free markets, but like many on the centre-left he hankers for Britain to acquire a few more of the characteristics of Scandinavian-style social democracy. Given where the casino capitalism of the past few years has left us, many will agree with him. That may not help the busted flush that is New Labour, but it is a warning to the Tories that the spirit of the age is not entirely with them.

The Storm: The World Economic Crisis & What it Means.
By Vince Cable.
Atlantic Books; 181 pages; £14.99

Eugène Ionesco's "Exit the King"

Forgotten gem

Apr 2nd 2009 | NEW YORK
From The Economist print edition

A comedy that is timely and timeless

IT IS tough to make a two-hour death-knell entertaining. Is there anything amusing about not wanting to die? Yes, if you are lucky enough to see "Exit the King", a largely forgotten work by Eugène Ionesco, a 20th-century French absurdist playwright. Directed by Neil Armfield, this new production at the Ethel Barrymore Theatre is darkly hilarious.

The show's success has much to do with Geoffrey Rush, a gifted Oscar-winning Australian actor who is here making his Broadway debut. With Mr Armfield he has written a new translation of the 1962 French original, gently revitalising what he has called a "forgotten masterpiece". More to the point, he delivers a feverishly brilliant performance as King Berenger I, a 400-year-old monarch on his last wobbly legs.

With the sunken eyes of a Munch painting and the floppy limbs that characterise the Marx brothers, Mr Rush's Berenger is a despot in decline. He rules over a crumbling palace and a ruined, shrinking country. His fate is sealed from the outset. "You're going to die in an hour-and-a-half," announces Queen Marguerite, his first wife (played with brittle reserve by Susan Sarandon, whom Mr Rush recruited for the part). "You're going to die at the end of the play." Decades after he wrote this play, Ionesco's teasing games still feel clever.

The king clings to life with clownish zeal and real desperation. His hair turns white and his sceptre becomes a cane. Stripped of his crown and cloak, he tumbles about in his pyjamas, knock-kneed and pigeon-toed. "Why was I born if it wasn't going to be for ever?" he cries. "Kings ought to be immortal." This is a very physical role, both dreadful and ridiculous—"like a tragic Punch and Judy show", Ionesco wrote in his notes. Mr Rush is supported by a terrific cast that includes a radiant Lauren Ambrose as the buoyant young queen and Andrea Martin as the overworked, bristling maid. As for Ms Sarandon, the role of wizened, sidelined queen doesn't quite play to her strengths. She comes across as caged.

There are contemporary parallels with the king's devastating leadership. Broken dykes have "flooded the country" and Queen Marguerite rants against "all those disastrous wars". Yet the play's real power lies in its timelessness. Yes, King Berenger is a selfish and narcissistic fool, but also he is afraid of dying. "I want to start again," he says. The audience is with him all the way.

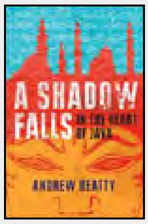
A shadow falls

In the heart of Java

Apr 2nd 2009
From The Economist print edition

EVERY year Indonesia enjoys a national holiday for *nyepi*, the Hindu day of silence, which this year fell on March 26th. It is not a holiday in India, Hinduism's homeland. Similarly, in Bayu, once part of one of the last Hindu kingdoms in East Java to be conquered and converted to Islam, villagers welcome the Ramadan fast with a feast, scandalising some of the clerics.

A Shadow Falls: In the Heart of Java
By Andrew Beatty



Faber and Faber; 336 pages; £12.99

Indonesian religion is "syncretic", a unique confection, and nowhere more so than in Java, much the most populous island in much the most populous Muslim nation on earth. This fascinating and moving book describes what "syncretism" means in daily life. The author, Andrew Beatty, an anthropologist, spent two periods in Bayu in the 1990s, with his young family. As he documented local customs and rituals, he became drawn into its cultural conflict: between "Javanism" (the pre-Islamic mystical tradition) and orthodox Islam.

Mr Beatty describes the mystics' ceremonies with sympathy: the interment of the afterbirth of a baby girl by her father, dressed and made up as a woman for the purpose; the night-long dramas finishing with the appearance of a were-tiger, the neighbourhood spirit; the *seblang*, a "fertility rite at which a nubile girl went into a trance and channelled local spirits".

The "shadow" of the title is that of encroaching Islamist orthodoxy. A religious teacher seeks out the author as a fellow educated man, assuming he must be on the side of modernisation, since "Islamisation and progress were the same thing". Politicians in Islamist parties in Jakarta make the same assumption. Women go to university, learn the proper way to do things and start wearing headscarves, chiding their mothers for being backward.

When the first woman in Bayu covers her head, during the author's first stay, her foster mother "could not bear to look at her". By the time Mr Beatty returns for a second stay, orthodoxy is on the march. He becomes embroiled in a dispute about the insomnia-inducing amplification of sermons from the local prayer house. One night the speakers blare out a preacher's rant about the need for holy war.

It is tempting to see this depressing scene as the book's conclusion: the Javanese idyll smashed by the incursions of alien extremism. But that hints at one of the book's two frustrations: it is not the conclusion. Well-written, with vivid characters, "A Shadow Falls" is as enthralling as a novel. And like a good novel, it poses the question: what happened next? At the time, 1997, Indonesia was in turmoil, on the brink of economic meltdown and the end of the Suharto dictatorship. East Java suffered a wave of mysterious killings. After Suharto, there was an explosion of Islamist parties. Most have now moved firmly into the mainstream. What the author calls "the ebb and flow of orthodoxy" moves both ways. The reader longs to know what Bayu is like today.

The second frustration is shared by all books on modern Indonesia: its failure to explain a terrible paradox. The author depicts Java as almost an ideal society "of social harmony, empathy and gentleness". Yet, a generation earlier, as Suharto came to power, Indonesia suffered a terrible peacetime slaughter when at least 500,000 people were killed. The author meets a man who ferried prisoners to their deaths in the back of a lorry. They were tipped over a cliff, and sometimes doused with petrol and set alight. "You could see them twitching in the ravine below." Bayu was home to both death-squad veterans and the families of their victims. Darker than the shadow of a putative future of Islamic orthodoxy is a bloody past that is both unexpiated and unexplained.

A Shadow Falls: In the Heart of Java.
By Andrew Beatty.
Faber and Faber; 336 pages; £12.99

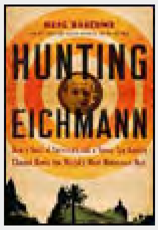
Adolf Eichmann

Manhunt

Apr 2nd 2009
From The Economist print edition

BRINGING old Nazis to justice was not a priority in the immediate aftermath of 1945. The three Western powers wanted to turn their zones of Germany into the Federal Republic, a functioning cold-war ally. Justice was delayed, denied or tied up in bureaucratic knots. But did that shabby, perhaps shameful compromise justify Israel's action in kidnapping Adolf Eichmann from Argentina in 1960 and putting him on trial in a country that did not exist at the time when he was planning and executing the Holocaust?

Hunting Eichmann: How a Band of Survivors and a Young Spy Agency Chased Down the World's Most Notorious Nazi
By Neal Bascomb



Houghton Mifflin Harcourt; 400 pages; $26. To be published in Britain by Quercus in September

Buy it at
Amazon.com
Amazon.co.uk

The unspoken assumption of Neal Bascomb's book is that the Israeli secret service's daring and risky plan was not only heroic and skilful, but also justified. It starts by retelling the long and frustrating hunt for Eichmann, whom sympathisers had helped flee to Argentina after the war (a shocking tale in itself). It was a chance remark by one of his sons to a girlfriend who, unknown to him, was half-Jewish, that gave the first clue. Even so, it took years to follow up.

AP

Not one to doff his cap

Those who like to believe that Mossad, the Israeli secret service, is the epitome of spookish efficiency may find themselves blinking at some of the mishaps and near-disasters that its posse encountered in Argentina. Clumsy snooping alarmed the Eichmanns, though not enough to prompt them to go into hiding. Having caught their quarry, the Israeli spy chiefs risked detection by ordering a further, madcap attempt to find another fugitive Nazi, Josef Mengele, a doctor responsible for hideous experiments at Auschwitz.

Nonetheless, the operation was both daring and brilliant. Eichmann was snatched from the street on his way home from work. One of the kidnappers—in an unplanned move—managed to persuade him that it would be to his advantage to stand trial in Israel, and put his side of the story. He boarded an El Al plane without protest, disguised as a crew member.

Mr Bascomb's understandable distaste for his subject does not prevent him giving a good flavour of Eichmann's slippery arguments once he went on trial: sometimes denying that he did anything wrong, sometimes saying he was only obeying orders, sometimes pleading other extenuating circumstances. He brings out well the paradox of Eichmann's genuine interest in Jewish history and culture (he greeted his captors with a Hebrew prayer), and the abominable crimes he committed.

Argentina, in those days infested with Nazi sympathisers, was furious at Israel's action. So were some other countries. Israel was unrepentant. The book spends a bit too long on the minutiae of the hunt and skates rather too quickly over the legal and ethical issues that it raised. Was it really so impossible to put Eichmann on trial in West Germany? The book criticises the prosecution's conduct at the trial, but with a frustrating lack of detail. A bigger flaw is the re-creation of dialogue 50 years on, a trick that gives the narrative immediacy but erodes the credibility that the author's research has earned.

Eichmann himself comes across as a pathetic figure, dwarfed both by the evil he committed and the efforts made to catch him. Like most of his fellow Nazis, he was monstrous only when fate gave him power. Without it, he was just a crotchety émigré with unpleasant views on Jews. Yet the story remains a gripping one: the shadowy world of ex-Nazis hiding away in a far-off continent, Germany's own struggle

of memory against forgetting, and a young country's clamorous desire for justice.

Hunting Eichmann: How a Band of Survivors and a Young Spy Agency Chased Down the World's Most Notorious Nazi.
By Neal Bascomb.
Houghton Mifflin Harcourt; 400 pages; $26. To be published in Britain by Quercus in September

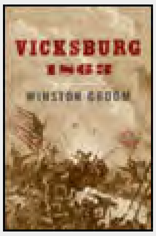
The American civil war

Mule steak and dressed rat

Apr 2nd 2009
From The Economist print edition

"NOT a dog barked at us, not a cat shied round a corner. Poor things, they had all been eaten in the straitness of the siege." The eyewitness was a Yankee chaplain with the Federal Army when on Independence Day, July 4th 1863, it entered Vicksburg, the previously impregnable town that commanded the Mississippi River. The fall of the so-called "Gibraltar of the West" hastened the end of the American civil war by cleaving the Confederacy in two and cutting its supplies of grain, livestock, munitions and men.

Vicksburg 1863
By Winston Groom



Knopf; 496 pages; $30

Buy it at
Amazon.com
Amazon.co.uk

Civil-war buffs will be most interested in Winston Groom's contribution to the contentious debate on whether General Joseph Johnston, the Confederate commander in the West, could and should have done more to relieve the defender of Vicksburg, General John Pemberton. Others will be struck more by the archaic nature of the Vicksburg campaign. The tactics of the besiegers and the sufferings of the besieged bring to mind medieval, or even Roman, times rather than mid-19th-century America.

Vicksburg was first "invested", that is blockaded and surrounded, so that its defenders could neither escape nor be reinforced or supplied. Moves to force the town's surrender followed. In earlier times catapults "reduced" the fortifications. At Vicksburg artillery was used instead. When even big guns failed to breach its defences yet another ancient tactic was employed. An escalade, or attack over the battlements, was ordered. That failed, too, and the attackers had to try to undermine the trenches and other fortifications through tunnelling, a popular medieval tactic.

Constant shelling compelled the inhabitants of Vicksburg to retreat into shelters, initially scooped-out holes in the ground. Shortages of food and drink forced prices up to levels only the rich could afford. A barrel of brandy or whisky, for instance, soared to 12 times its pre-war price. Poorer people struggled to subsist. Dressed rats hung alongside mule meat in the market.

Federal troops lived off the land, so other Mississippians suffered almost as much as those entrapped in Vicksburg. Their houses were looted, ransacked and burnt. Even blacks were plundered of their blankets, chickens, corn meal and garments. When the foragers found nothing left worth taking at plantations, they engaged in wanton destruction, singling out the crystal chandeliers "for particular abuse". There were even bad incidents of anti-Semitism from the Federal top military brass. General William Tecumseh Sherman complained about profiteering by Jewish peddlers and General Ulysses S. Grant issued a decree expelling all Jews from a large swathe of the South. President Abraham Lincoln revoked the order, noting that it "proscribed an entire religious class" and that Jews were fighting in the ranks of the Federal Army. Along with Jefferson Davis, his Southern counterpart, he is among the few to emerge with honour from this whole sorry story.

Vicksburg 1863.
By Winston Groom.
Knopf; 496 pages; $30

Leaving Tangier

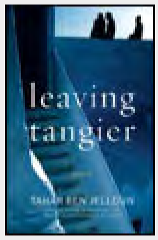
Tahar Ben Jelloun

Apr 2nd 2009
From The Economist print edition

IN HIS latest work to be translated into English, Tahar Ben Jelloun, Morocco's best-known novelist, examines how much people are willing to sacrifice to start a new life in Europe, and the consequences of taking flight. Mr Ben Jelloun is no stranger to these issues, having left Morocco himself in 1971 to study in Paris. He has won numerous literary prizes, including the Prix Goncourt in 1987, an award he now judges.

In "Leaving Tangier", the author draws on his research as a social psychiatrist that also inspired an earlier novel, "Solitaire", as a way of exploring psychological and sexual dysfunctions that arise as a result of migration. Azel, an educated, heterosexual young man from Tangier, is unable to find work and becomes obsessed with his desire to escape from Morocco. He spends every evening at the Café Haha, gazing longingly at the lights twinkling on the Spanish coastline just 20 miles (32km) away. When he meets Miguel Lopez, a rich Spanish homosexual, Azel seizes the opportunity and leaves his family and his country behind to become Miguel's lover in Barcelona. However, he underestimates the extent to which this decision will destroy both his sexuality and his sense of self.

Leaving Tangier
By Tahar Ben Jelloun. Translated by Linda Coverdale



Penguin; 288 pages; $15. Arcadia Books; £11.99

Buy it at
Amazon.com
Amazon.co.uk

In 40 short chapters Mr Ben Jelloun weaves together a tapestry of exile and loss as he follows his characters through the dream and reality of leaving Tangier. Al Afia, "the fire", smuggles boatloads of illegal emigrants across the strait, unashamedly profiting from an enterprise that often ends in arrest or drowning. Azel's sister, Kenza, enters into a marriage of convenience with Miguel and obtains a job and a resident's permit in Spain, but her dream of finding "love, true love" is snatched away. Back in Tangier, the most touching figure is Malika, an imaginative young girl who dies before any of her dreams can be realised.

The invisible, omnipresent character in the text is Morocco itself, as Mr Ben Jelloun demonstrates the difficulty of ever really "leaving" your country. Although most of the plot takes place in Spain, the characters' thoughts continually turn back to Morocco, a country that remains the "dearest and greatest" of their anxieties. "Leaving Tangier" is a brave, unflinching look at the issues underlying economic migration from North Africa—and the hard choices people make between roots and wings.

Leaving Tangier.
By Tahar Ben Jelloun. Translated by Linda Coverdale.
Penguin; 288 pages; $15. Arcadia Books; £11.99

John Hope Franklin

Apr 2nd 2009
From The Economist print edition

John Hope Franklin, historian of race in America, died on March 25th, aged 94

eyevine

HIS chief pleasures were contemplative and patient. With watering can and clippers, he would potter in his greenhouse among hundreds of varieties of orchids. Or, standing in a river, he would wait for hours until a fish tickled his line. These were, one could say, typical historian's amusements; very close, in rhythm and character, to the painstaking, careful accumulation of tiny pieces of fact.

And yet what John Hope Franklin collected, over a lifetime of scholarship, were scraps of horror. Five dollars for the cost of a branding iron. A deed of sale, in Virginia in 1829, for a male slave "of a yellow colour" who "is not in the habit of running away". Or the testimony from 1860 of Edward Johnson, a black child apprentice:

> I was tacon and plased with a rope a round my rists my back intiarly naked and swong up then and there Each of [the men] tuck a cow hide one on Either side and beet me in such a manner when they let me down I fanted and lay on the ground 2 hours

To these Mr Franklin could add from his own experience. The train journey to Checotah, Oklahoma, when he was six, that ended when his mother refused to move from the whites-only carriage. His father's small law office in Tulsa, reduced to rubble after a race riot in 1921. The day he was told by a white woman whom he was helping, at 12, across the road, that he should take his "filthy hands" off her. And the warm evening when he went to buy ice cream in Macon, Mississippi—a tall 19-year-old student from Fisk University, scholarly in his glasses—only to find as he left the store that a semi-circle of white farmers had formed to block his exit, silently implying that he should not try to break through their line.

Academia offered no shelter. He excelled from high school onwards, eventually earning a doctorate at Harvard and becoming, in 1956, the first black head of an all-white history department at a mostly white university, Brooklyn College. Later, the University of Chicago recruited him. But in Montgomery, Louisiana, the archivist called him a "Harvard nigger" to his face. In the state archives in Raleigh, North Carolina, he was confined to a tiny separate room and allowed free run of the stacks because the white assistants would not serve him. At Duke in 1943, a university to which he returned 40 years later as a teaching professor, he could not use the library cafeteria or the washrooms.

Whites, he noted, had no qualms about "undervaluing an entire race". Blacks were excluded both from

their histories, and from their understanding of how America had been made. Mr Franklin's intention was to weave the black experience back into the national story. Unlike many after him, he did not see "black history" as an independent discipline, and never taught a formal course in it. What he was doing was revising American history as a whole. His books, especially "From Slavery to Freedom" (1947), offered Americans their first complete view of themselves.

Thomas Jefferson's wine

Militancy was not in his nature. He was too scrupulous a historian for that, and too courteous a man. Asked whether he hated the South, he would say, on the contrary, that he loved it. His deepest professional debt was to a white man, Ted Currier, who had inspired him to study history and had given him $500 to see him through Harvard. Yet, alongside the dignity and the ready smiles, a sense of outrage burned. He longed to tell white tourists thronging Washington that the Capitol had been built by slaves, and that Pennsylvania Avenue had held a slave market, "right by where the Smithsonian is". Profits made possible by enslaving blacks had not only allowed Thomas Jefferson to enjoy fine French wines: they had also underpinned America's banks, its economic dynamism and its dominance in the world. The exploitation of blacks was something he admitted he had "never got over".

Nor had America got over it, despite the march from Selma, in which Mr Franklin led a posse of historians, and *Brown v Board of Education*, where he lent his scholarship to help prove that the Framers had not meant to impose segregation on the public schools. The "colour line", as he called it, remained "the most tragic and persistent social problem" the country faced. His own many black firsts—president of the American Historical Association and the Southern Historical Association, membership of Washington's Cosmos Club—had not necessarily opened the door to others. The night before he received the Presidential Medal of Freedom in 1995, a woman at the Cosmos Club asked him to fetch her coat. He was overjoyed by Barack Obama's election, but could not forget the poor, immobile blacks revealed by Hurricane Katrina.

He yearned to improve things, but wondered how. Financial reparations he was doubtful about; apologies seemed trifling. Only time, in historical quantities, seemed likely to make a difference. For some months he was chairman of Bill Clinton's Initiative on Race, a disorganised effort that ended by recommending "community co-operation". Hostile letters poured in, mostly from people who did not think the subject worth talking about. Mr Franklin took them in his stride. He would go and work on his next book, or retire to the greenhouse, implements in hand; and practise patience.

Overview

Apr 2nd 2009
From The Economist print edition

There was mixed news from **Japan**. The Bank of Japan's quarterly Tankan index of sentiment among large manufacturers fell to -58, the lowest in the history of the survey, which dates back to 1974. The country's domestic production of vehicles was 56% lower in February than a year earlier. Car sales in March were down by 32% on the same month in 2008. However, February did at least see Japanese companies cutting inventories at the fastest rate since records began in 1953. That raised hopes that the bottom of the country's manufacturing slump may be in sight.

America's Federal Reserve bought $6 billion-worth of Treasuries, maturing in three to four years' time, on April 1st. The purchases were part of plans announced on March 18th to buy over $300 billion in Treasury securities in an effort to lower borrowing rates for consumers and get credit flowing again.

South Korea's exports fell by 21.2% in March from a year earlier. Exports to China, the country's largest export market, dropped by 17.2% during the first 20 days of March. Imports were down by even more: 36%.

Brazil's industrial output continued to plummet. It was 17% lower in February than a year earlier.

The dollar value of **India's** exports went down by 21.7% in the year to February, according to the country's commerce ministry. But an even sharper drop in imports, of 23%, meant that the trade deficit narrowed, to $4.9 billion.

Output, prices and jobs

Apr 2nd 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−0.8 Q4	−6.3	−2.2	+1.9	−11.8 Feb	+0.2 Feb	+4.0	−0.6	8.1 Feb
Japan	−4.3 Q4	−12.1	−5.3	+0.5	−38.4 Feb	−0.1 Feb	+1.0	−0.8	4.4 Feb
China	+6.8 Q4	na	+6.0	+7.0	+3.8 Jan-Feb	−1.6 Feb	+8.7	−0.2	9.0 2008
Britain	−2.0 Q4	−5.9	−3.1	+0.5	−11.4 Jan	+3.2 Feb§	+2.5	+1.0	6.5 Jan††
Canada	−0.7 Q4	−3.4	−1.5	+1.7	−7.8 Jan	+1.4 Feb	+1.8	+0.5	7.7 Feb
Euro area	−1.3 Q4	−5.8	−2.4	+0.7	−17.3 Jan	+0.6 Mar	+3.6	+0.6	8.5 Feb
Austria	+0.5 Q4	−0.8	−1.3	+0.8	−6.5 Jan	+1.3 Feb	+3.2	+0.8	4.5 Feb
Belgium	−0.8 Q4	−6.5	−1.8	+0.9	−6.5 Dec	+0.6 Mar	+4.4	+1.1	11.2 Feb‡‡
France	−1.1 Q4	−4.4	−1.9	+0.7	−13.8 Jan	+0.9 Feb	+2.8	+0.4	8.6 Feb
Germany	−1.7 Q4	−8.2	−3.2	+0.8	−19.2 Jan	+0.5 Mar	+3.1	+0.4	8.1 Mar
Greece	+2.4 Q4	+1.2	−3.4	−0.4	−10.2 Jan	+1.6 Feb	+4.4	+0.9	7.8 Dec
Italy	−2.9 Q4	−7.5	−2.7	+0.5	−16.7 Jan	+1.6 Feb	+2.9	+1.0	6.9 Q4
Netherlands	−0.6 Q4	−3.8	−1.9	+0.8	−13.3 Dec	+2.0 Feb	+2.2	+0.7	4.1 Feb††
Spain	−0.7 Q4	−3.8	−2.5	nil	−23.6 Jan	+0.7 Feb	+4.4	+0.6	15.5 Feb
Czech Republic	+0.7 Q4	−3.7	−2.0	+1.6	−23.3 Jan	+2.0 Feb	+7.5	+1.8	7.4 Feb
Denmark	−3.7 Q4	−7.3	−2.2	+0.7	−9.2 Jan†††	+1.9 Feb	+3.1	+1.2	2.5 Feb
Hungary	+2.0 Q4	−3.9	−3.0	+0.4	−21.0 Jan	+3.0 Feb	+6.9	+2.9	9.1 Feb††
Norway	+0.8 Q4	+5.6	−1.2	+0.5	−0.6 Jan	+2.5 Feb	+3.7	+1.7	3.1 Jan***
Poland	+2.9 Q4	na	+0.7	+2.2	−14.9 Jan	+3.3 Feb	+4.2	+3.0	10.9 Feb‡‡
Russia	+1.1 Q4	na	−3.0	+2.0	−13.2 Feb	+12.0 Feb	+12.7	+13.5	8.5 Feb‡‡
Sweden	−4.9 Q4	−9.3	−2.2	+0.9	−22.9 Jan	+0.9 Feb	+3.1	−0.1	8.0 Feb‡‡
Switzerland	−0.1 Q4	−1.2	−1.6	+0.7	−6.0 Q4	+0.2 Feb	+2.4	−0.1	3.1 Feb
Turkey	−6.2 Q4	na	−2.0	+1.5	−21.3 Jan	+7.7 Feb	+9.1	+7.8	12.3 Q4‡‡
Australia	+0.3 Q4	−2.1	−0.3	+1.6	+3.8 Q3	+3.7 Q4	+3.0	+2.1	5.2 Feb
Hong Kong	−2.5 Q4	−7.8	−5.9	−0.2	−10.3 Q4	+0.8 Feb	+6.3	+1.1	5.0 Feb††
India	+5.3 Q4	na	+5.0	+6.4	−0.5 Jan	+9.6 Feb	+5.5	+5.4	6.8 2008
Indonesia	+5.2 Q4	na	−1.3	+0.6	−6.1 Jan	+7.9 Mar	+6.3	+3.9	8.4 Aug
Malaysia	+0.1 Q4	na	−0.3	+2.8	−20.2 Jan†††	+3.7 Feb	+2.7	+1.1	3.1 Q3
Pakistan	+5.8 2008**	na	+1.2	+3.2	−1.6 Dec	+21.1 Feb	+11.3	+10.1	5.6 2007
Singapore	−4.2 Q4	−16.4	−7.5	+1.9	−22.4 Feb	+1.9 Feb	+6.5	+0.9	2.6 Q4
South Korea	−3.4 Q4	−20.8	−5.9	+0.3	−25.6 Jan	+3.9 Mar	+3.9	−0.6	3.5 Feb
Taiwan	−8.4 Q4	na	−6.5	+0.1	−27.1 Feb	−1.3 Feb	+3.9	−1.0	5.6 Feb
Thailand	−4.3 Q4	−22.2	−4.4	+1.8	−21.3 Jan	−0.2 Mar	+5.3	−1.2	2.4 Jan
Argentina	+4.9 Q4	−1.2	−2.8	+1.5	−4.4 Jan	+6.8 Feb	+8.4	+6.4	7.3 Q4‡‡
Brazil	+1.3 Q4	−13.6	−1.5	+2.7	−17.0 Feb	+5.9 Feb	+4.6	+4.4	8.5 Feb‡‡
Chile	+0.2 Q4	−8.3	+0.4	+2.3	−11.5 Feb	+5.5 Feb	+8.1	+3.7	8.5 Feb††‡‡
Colombia	+3.1 Q3	+2.9	−1.0	+1.5	−10.7 Jan	+6.5 Feb	+6.4	+5.0	14.2 Jan‡‡
Mexico	−1.6 Q4	−10.3	−2.6	+1.4	−11.1 Jan	+6.2 Feb	+3.7	+4.8	5.3 Feb‡‡
Venezuela	+3.2 Q4	na	−5.0	−5.4	−25.4 Dec	+29.5 Feb	+25.4	+30.1	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.8	+3.9	+7.3 Q3	+13.5 Feb	+12.1	+8.1	8.8 Q4‡‡
Israel	+1.2 Q4	−0.5	+0.4	+2.6	−4.1 Jan	+3.4 Feb	+3.6	+1.8	6.3 Q4
Saudi Arabia	+3.5 2007	na	+0.4	+3.3	na	+6.9 Feb	+7.4	+4.3	na
South Africa	+1.0 Q4	−1.8	−0.8	+3.1	−11.1 Jan	+8.6 Feb	+9.8	+6.0	21.9 Dec‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−9.7 Q4	na	−8.0	−1.5	−26.8 Jan	+3.4 Feb	+11.3	+1.0	9.2 Dec
Finland	−2.4 Q4	−5.0	−2.8	+0.5	−19.5 Jan†††	+1.7 Feb	+3.7	+0.7	7.1 Feb
Iceland	−1.3 Q4	−3.6	−12.4	−0.9	+0.4 2007	+15.2 Mar	+8.7	+12.5	6.6 Jan‡‡
Ireland	−7.5 Q4	−25.7	−4.8	−1.4	−0.8 Jan	−1.7 Feb	+4.8	−0.7	10.4 Feb
Latvia	−10.3 Q4	na	−12.0	−2.0	−23.9 Jan	+9.6 Feb	+16.7	+3.0	12.3 Jan
Lithuania	−2.2 Q4	−5.5	−8.0	−2.5	na	+8.7 Feb	+10.7	+4.2	7.0 Jan‡‡
Luxembourg	−0.3 Q3	−5.5	−2.9	−0.2	−15.9 Nov	+1.2 Feb	+3.1	+0.5	5.5 Jan‡‡
New Zealand	−2.3 Q4	−2.3	−3.2	+0.5	−0.5 Q3	+3.4 Q4	+3.2	+1.6	4.6 Q4
Peru	+3.2 Jan	na	+3.0	+4.0	+3.9 Dec	+5.5 Feb	+4.8	+4.7	10.3 Jan††
Philippines	+4.5 Q4	+4.1	−0.6	+1.6	−15.4 Dec	+7.3 Feb	+5.4	+1.9	6.8 Q4‡‡
Portugal	−1.8 Q4	−6.2	−3.5	−0.4	−19.1 Jan	+0.2 Feb	+2.9	−1.0	7.8 Q4‡‡
Slovakia	+2.5 Q4	na	+2.0	+2.8	−27.0 Jan	+3.1 Feb	+4.0	+2.8	9.7 Feb‡‡
Slovenia	−0.8 Q4	na	+0.4	+1.2	−17.4 Jan	+2.1 Feb	+6.5	+2.0	7.8 Jan‡‡

*% change on previous quarter, annual rate. † *The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate nil in Feb. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Apr 2nd 2009
From The Economist print edition

The Economist commodity-price index

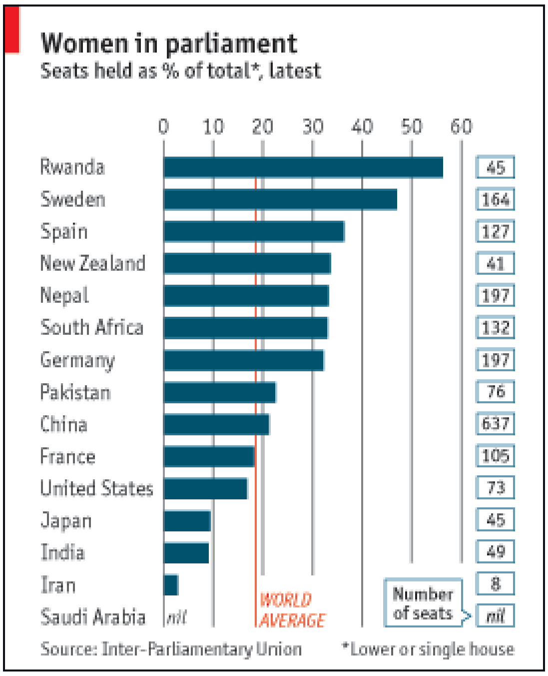
2000=100

	Mar 24th	Mar 31st*	% change on one month	% change on one year
Dollar index				
All items	161.7	161.5	+7.9	-34.9
Food	188.8	186.9	+7.1	-22.9
Industrials				
All	126.5	128.6	+9.5	-49.6
Nfa†	110.8	112.8	+6.9	-39.6
Metals	135.1	137.3	+10.8	-53.1
Sterling index				
All items	166.4	170.9	+5.7	-10.2
Euro index				
All items	110.5	112.5	+2.1	-23.5
Gold				
$ per oz	923.50	916.10	+0.7	+4.2
West Texas Intermediate				
$ per barrel	53.55	49.39	+19.5	-51.1

*Provisional †Non-food agriculturals.

Women in parliament

Apr 2nd 2009
From The Economist print edition



Women make up more than half of Rwanda's 80 MPs, according to the Inter-Parliamentary Union, an international association of lawmakers. Women are also relatively well represented in Sweden, where they hold 47% of the seats in the country's parliament. The proportion in New Zealand, which was the first country to allow women to vote, is over a third. In Pakistan's parliament, where they benefit from having some seats set aside for them, women make up 22.5% of members. That is a higher proportion than in either France (18.2%) or America (16.8%). The sheer size of its parliament means that China has the largest number of women MPs, even though they make up just over a fifth of its parliamentarians.

Trade, exchange rates, budget balances and interest rates

Apr 2nd 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Apr 1st	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−797.1 Jan	−673.3 Q4	−3.3	–	–	−13.7	0.50	2.65
Japan	+28.5 Jan	+143.3 Jan	+2.0	98.8	103	−5.6	0.54	1.34
China	+311.5 Feb	+400.7 Q2	+6.1	6.83	7.02	−3.6	1.22	3.33
Britain	−167.7 Jan	−44.6 Q4	−2.0	0.70	0.50	−11.3	1.70	3.12
Canada	+41.6 Jan	+11.3 Q4	−1.1	1.27	1.02	−2.8	0.39	2.94
Euro area	−53.8 Jan	−90.2 Jan	−0.8	0.76	0.64	−5.3	1.50	3.00
Austria	−2.4 Dec	+16.8 Q3	+1.6	0.76	0.64	−3.4	1.50	4.00
Belgium	+8.2 Jan	−12.1 Dec	+0.7	0.76	0.64	−3.6	1.52	3.95
France	−80.6 Jan	−56.8 Jan	−2.2	0.76	0.64	−6.3	1.50	3.61
Germany	+250.7 Jan	+224.3 Jan	+5.3	0.76	0.64	−3.9	1.50	2.99
Greece	−65.0 Dec	−49.9 Jan	−12.6	0.76	0.64	−4.9	1.50	5.42
Italy	−18.4 Jan	−73.1 Jan	−2.0	0.76	0.64	−4.3	1.50	4.33
Netherlands	+51.7 Jan	+65.3 Q4	+6.2	0.76	0.64	−1.3	1.50	3.74
Spain	−131.7 Jan	−145.2 Jan	−7.8	0.76	0.64	−7.4	1.50	4.05
Czech Republic	+3.8 Jan	−7.3 Jan	−2.3	20.5	16.1	−3.0	2.46	5.60
Denmark	+6.7 Jan	+6.8 Jan	+1.0	5.63	4.78	−2.0	4.50	3.63
Hungary	−0.4 Jan	−13.0 Q4	−3.7	230	165	−2.7	9.83	11.60
Norway	+73.7 Feb	+83.4 Q4	+10.9	6.74	5.15	10.6	2.99	3.76
Poland	−23.1 Jan	−28.1 Jan	−4.9	3.45	2.24	−2.2	4.16	6.10
Russia	+170.8 Jan	+98.9 Q4	−2.2	33.9	23.6	−8.0	13.00	10.82
Sweden	+14.3 Feb	+40.3 Q4	+6.7	8.23	6.00	−3.3	0.28	3.03
Switzerland	+18.4 Feb	+53.3 Q4	+8.7	1.15	1.01	−2.0	0.40	2.06
Turkey	−60.8 Feb	−37.2 Jan	−3.4	1.63	1.29	−4.2	11.70	7.69‡
Australia	+2.2 Feb	−44.1 Q4	−5.3	1.44	1.10	−3.1	3.09	4.39
Hong Kong	−25.1 Feb	+30.6 Q4	+9.1	7.75	7.79	−4.5	0.90	1.83
India	−113.3 Feb	−37.5 Q4	−3.7	50.7	40.0	−7.2	4.94	7.51
Indonesia	+7.2 Feb	+0.6 Q4	−0.4	11,565	9,215	−2.9	9.27	9.84‡
Malaysia	+42.2 Jan	+39.1 Q4	+7.8	3.65	3.19	−6.6	2.09	3.74‡
Pakistan	−19.7 Feb	−15.3 Q4	−5.8	80.6	62.8	−6.4	12.77	20.08‡
Singapore	+14.7 Feb	+27.1 Q4	+15.4	1.52	1.38	−4.1	0.56	1.94
South Korea	−2.8 Mar	+0.7 Feb	+1.2	1,380	974	−3.5	2.41	5.02
Taiwan	+6.3 Feb	+25.0 Q4	+7.9	33.8	30.4	−5.0	0.90	1.43
Thailand	+6.1 Feb	+4.5 Feb	+1.4	35.5	31.5	−4.7	1.80	2.78
Argentina	+13.1 Feb	+7.6 Q4	−0.5	3.72	3.17	−0.8	14.44	na
Brazil	+25.0 Mar	−25.7 Feb	−2.0	2.29	1.73	−1.9	11.16	6.16‡
Chile	+7.6 Feb	−3.4 Q4	−3.4	581	436	−3.5	2.88	3.58‡
Colombia	+2.1 Feb	−6.8 Q4	−4.0	2,531	1,826	−3.3	7.68	6.97‡
Mexico	−16.0 Feb	−2.4 Q4	−3.4	14.0	10.6	−3.2	6.35	7.56
Venezuela	+39.2 Q4	+39.2 Q4	+0.1	6.15	3.85§	−5.3	17.20	6.55‡
Egypt	−26.8 Q4	−1.3 Q4	−0.5	5.63	5.45	−7.0	10.26	3.67‡
Israel	−12.8 Feb	+1.6 Q4	+1.9	4.20	3.57	−5.0	0.59	3.11
Saudi Arabia	+197.4 2008	+124.0 2008	−8.0	3.75	3.75	−8.7	1.15	na
South Africa	−8.0 Feb	−21.0 Q4	−7.0	9.40	7.82	−3.3	8.78	8.58
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−3.4 Jan	−1.9 Jan	−6.2	11.8	10.0	−3.4	7.12	na
Finland	+8.8 Jan	+4.8 Jan	+2.4	0.76	0.64	−4.1	1.47	3.68
Iceland	+0.1 Feb	−5.6 Q4	+0.5	120	75.0	−9.5	15.50	na
Ireland	+44.3 Jan	−12.7 Q4	−1.7	0.76	0.64	−12.4	1.50	5.41
Latvia	−6.1 Jan	−4.0 Jan	−5.0	0.54	0.45	−6.0	10.34	na
Lithuania	−6.6 Jan	−5.6 Jan	−7.5	2.61	2.21	−2.5	7.08	na
Luxembourg	−7.9 Dec	+3.0 Q4	na	0.76	0.64	−3.9	1.50	na
New Zealand	−3.5 Feb	−11.3 Q4	−6.3	1.78	1.27	−6.3	3.65	5.09
Peru	+2.6 Jan	−4.2 Q4	−3.9	3.15	2.72	−1.8	6.00	na
Philippines	−7.6 Jan	+4.2 Dec	+2.9	48.3	41.5	−2.6	4.50	na
Portugal	−34.0 Dec	−29.0 Jan	−9.4	0.76	0.64	−4.7	1.50	4.52
Slovakia	−1.5 Jan	−7.0 Jan	−4.8	22.8	20.8	−2.8	1.35	4.34
Slovenia	−4.5 Jan	−3.1 Dec	−4.3	0.76	0.64	−3.4	1.50	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

Apr 2nd 2009
From The Economist print edition

Markets

	Index	% change on	Dec 31st 2008	
	Apr 1st	one week	in local currency	in $ terms
United States (DJIA)	7,761.6	+0.2	−11.6	−11.6
United States (S&P 500)	811.1	−0.3	−10.2	−10.2
United States (NAScomp)	1,551.6	+1.5	−1.6	−1.6
Japan (Nikkei 225)	8,351.9	−1.5	−5.7	−13.5
Japan (Topix)	793.8	−3.0	−7.6	−15.3
China (SSEA)	2,527.3	+5.1	+32.2	+32.0
China (SSEB, $ terms)	162.3	+7.4	+46.6	+46.3
Britain (FTSE 100)	3,955.6	+1.4	−10.8	−10.8
Canada (S&P TSX)	8,941.8	+1.6	−0.5	−3.1
Euro area (FTSE Euro 100)	645.7	−2.0	−13.5	−17.7
Euro area (DJ STOXX 50)	2,097.6	−2.4	−14.3	−18.4
Austria (ATX)	1,711.6	+0.6	−2.2	−7.0
Belgium (Bel 20)	1,772.8	+0.9	−7.1	−11.6
France (CAC 40)	2,839.6	−1.9	−11.8	−16.0
Germany (DAX)*	4,131.1	−2.2	−14.1	−18.3
Greece (Athex Comp)	1,678.7	−0.9	−6.0	−10.6
Italy (S&P/MIB)	16,047.0	−1.3	−17.5	−21.5
Netherlands (AEX)	220.7	−2.2	−10.3	−14.6
Spain (Madrid SE)	836.2	−1.4	−14.3	−18.5
Czech Republic (PX)	755.2	−6.4	−12.0	−17.3
Denmark (OMXCB)	218.7	+3.8	−3.3	−8.0
Hungary (BUX)	11,161.0	−1.4	−8.8	−24.1
Norway (OSEAX)	271.0	−2.0	+0.3	+4.3
Poland (WIG)	24,145.7	−5.2	−11.3	−23.9
Russia (RTS, $ terms)	685.5	−7.5	+20.4	+8.5
Sweden (Aff.Gen)‡	192.8	−0.4	−2.2	−6.1
Switzerland (SMI)	5,014.9	+0.9	−9.4	−15.9
Turkey (ISE)	25,943.6	+1.6	−3.4	−8.7
Australia (All Ord.)	3,527.2	−0.5	−3.6	−4.6
Hong Kong (Hang Seng)	13,519.5	−0.8	−6.0	−6.0
India (BSE)	9,902.0	+2.4	+2.6	−1.4
Indonesia (JSX)	1,461.7	+2.9	+7.8	+1.6
Malaysia (KLSE)	884.2	+0.6	+0.8	−4.3
Pakistan (KSE)	6,931.9	+3.9	+18.2	+16.1
Singapore (STI)	1,702.3	+0.6	−3.4	−8.6
South Korea (KOSPI)	1,233.4	+0.4	+9.7	+0.1
Taiwan (TWI)	5,314.5	−0.6	+15.8	+12.3
Thailand (SET)	430.1	−1.6	−4.4	−6.4
Argentina (MERV)	1,134.6	+0.2	+5.1	−2.4
Brazil (BVSP)	41,976.0	+0.4	+11.8	+13.7
Chile (IGPA)	12,029.4	−0.8	+6.2	+16.6
Colombia (IGBC)	8,044.3	+0.2	+6.4	−5.5
Mexico (IPC)	19,880.4	−1.9	−11.2	−12.1
Venezuela (IBC)	43,857.6	+2.2	+25.0	+34.6
Egypt (Case 30)	4,212.3	+1.1	−8.4	−10.3
Israel (TA-100)	666.3	+1.8	+18.1	+6.3
Saudi Arabia (Tadawul)	4,717.4	+1.6	−1.8	−1.7
South Africa (JSE AS)	20,742.0	−2.4	−3.6	−5.1
Europe (FTSEurofirst 300)	745.1	+0.2	−10.4	−14.8
World, dev'd (MSCI)	817.6	−1.4	−11.2	−11.2
Emerging markets (MSCI)	580.8	−1.1	+2.4	+2.4
World, all (MSCI)	205.2	−1.4	−9.9	−9.9
World bonds (Citigroup)	770.5	−0.9	−4.9	−4.9
EMBI+ (JPMorgan)	403.2	+0.7	+3.0	+3.0
Hedge funds (HFRX)‡	1,027.5	−0.3	+0.7	+0.7
Volatility, US (VIX)	42.3	42.3	40.0	(levels)
CDSs, Eur (iTRAXX)†	198.4	+8.7	−1.8	−6.6
CDSs, N Am (CDX)†	269.5	+7.7	+15.4	+15.4
Carbon trading (EU ETS) €	12.2	+14.3	−24.6	−28.3

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡Mar 31st

Sovereign bond ratings

Apr 2nd 2009
From The Economist print edition

At the end of 2008 61% of sovereign bond issuers were classed as investment grade by Moody's, a rating agency. That share was a little lower than a year or two before. Over a longer period, it has fallen markedly, mainly because emerging economies' governments, which tend to be riskier, have gained access to international debt markets. Last year there were 108 sovereign issuers; in 1983 there were only 14, all investment grade. By 1995 the proportion of issuers with investment grades had slipped to 78% and the share with Moody's top mark, Aaa, had fallen from three-quarters to one-fifth. In 2008 18% of issuers were rated Aaa. The proportion at B or lower was 23%, up from 7% in 1995.